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88-433

No. 88-

Supreme Court, U.S.
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1988

TERRYDALE LIQUIDATING TRUST,

Petitioner,

-v-

HERBERT BARNESS, JOHN F. BISHOP, EDGAR H. CHAPPELL, CHARLES W. CORBITT, GEORGE S. MANN, BROOKS WALKER, JR., LOUIS W. WALKER, and CHARLES M. WILLIAMS, individually and as Trustees of, and DAVID B. BRYANT as Trustee of, SAN FRANCISCO REAL ESTATE INVESTORS, and KEITH L. BROWN, individually, and as SAN FRANCISCO REAL ESTATE INVESTORS, INC.,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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September 9, 1988

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Questions Presented

1. Whether the judgment should be set aside for deliberate fraud on the court where respondent and its attorneys secretly tampered with petitioner's seven key witnesses by agreeing before trial that respondent would pay $50,000 for the witnesses' attorneys' fees?

2. Whether an award of over $1.5 million in attorneys' fees and expenses to respondent must be stricken where the respondent and its attorneys flagrantly flouted their obligations to the court (a) by illegally tampering with petitioner's witnesses and (b) by repeatedly misrepresenting and withholding critical facts as they pressed the frivolous defense of lack of personal jurisdiction for over one and one half years.

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TERRYDALE LIQUIDATING TRUST,

Petitioner,

v.

HERBERT BARNESS, et al.,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

Terrydale Liquidating Trust ("Terrydale") hereby petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Second Circuit.

OPINIONS BELOW

The opinion of the United States Court of Appeals for the Second Circuit is not reported (1a).[1] Some of the decisions of the district court (Sand, J.) which form the basis for this petition are reported; others are not. 642 F. Supp. 917 (S.D.N.Y. 1986), (13a); (194a); (214a); (10a).

JURISDICTION

The judgment of the Second Circuit was entered on May 12, 1988. (1a). On August 2, 1988, Justice Marshall extended the time for filing this petition to and including September 9, 1988. The jurisdiction of this Court is invoked under 28 U.S.C. Sec. 1254(1).

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[1] References to the separately bound Appendix are indicated by page number, followed by "a".

STATEMENT

This case, based on diversity jurisdiction, involves two matters of serious misconduct by respondent and its attorneys which tainted the judgment. The first involves the disclosure after trial of a secret pre-trial agreement by respondent-defendant San Francisco Real Estate Investors ("SFREI") and its attorneys, Skadden, Arps, Slate, Meagher & Flom, ("Skadden" or "Skadden Arps") for SFREI to pay $50,000 for the attorneys' fees of seven key witnesses called by petitioner-plaintiff Terrydale Liquidating Trust ("TLT").[2] The second involves respondent's and its attorneys' scheme of deliberate deception of the court and petitioner in pursuing its frivolous defense of lack of personal jurisdiction. After trial and despite this undisputed misconduct, the district court refused to grant petitioner's request for a new trial and awarded respondent $1.5 million for its attorneys' fees and expenses based upon a "prevailing party" contractual provision.

A. Background

TLT is successor in interest to Terrydale Realty Trust ("TRT"), a Missouri real estate investment trust. In response to an unsolicited tender offer for TRT shares by BCG Associates ("BCG"), the TRT trustees, in order to defeat that offer, approved the sale of four Denver office buildings (80% of TRT's assets) in February 1981 to "white knight" respondent-defendant SFREI. The TRT trustees simultaneously voted to liquidate the trust and to declare a liquidating dividend, thereby thwarting the tender offer.

The beneficiaries of TRT, now TLT, who were never given an opportunity to vote on the SFREI transaction, claimed that the TRT trustees had engaged in a "fire sale" at 50 cents on the dollar and undersold the assets by at least $14 million. TLT sued (1) the seller, the former trustees of TRT, for breach of fiduciary duty and Declaration of Trust and (2) the purchaser, SFREI, as aider

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[2] The $50,000 includes $25,000 in attorneys' fees and $1,714.15 in expenses paid by SFREI to Williams & Connolly, Esqs. on July 31,1986 (after the testimony of the seven witnesses and before decision) (146a) and $17,490 in attorneys' fees and $7,562.33 in expenses paid by SFREI to Polsinelli, White & Vardeman, Esqs. on August 27, 1986, one day after the decision in SFREI's favor (146a).

and abettor because of its knowledge of the breaches, and in any event, as constructive trustees because of its notice of TRT's breaches.

The former trustees of TRT were petitioner's key witnesses at trial: J. Russell Gramlich, his son John J. Gramlich, J. Harlan Stamper, John D. O' Flaherty, and Thomas J. Murphy. The TRT assets were managed by Terrydale Management Corporation ("TMC"), which was controlled by the Gramlich family. Two other key witnesses were Michael J. Gramlich (J.Russell Gramlich's son) and James A. Kostoryz (J. Russell Gramlich's son-in-law), vice presidents of TMC.

Petitioner called the seven key witnesses to establish material facts in the case; namely, the self-interest of certain trustees; the lack of independence of others, *i.e.* their "control and domination" by the interested trustees; and the fact that the TRT trustees acted without sufficient information about the current values of the subject properties. The district court's post-trial opinion manifests its reliance on the trial testimony of the TRT trustees (22a, 23a, 24a, 33a, 34a, 40a, 43a, 55a, 56a).

B. SFREI's and its Attorneys' Repeated Deception on the Issue of Jurisdiction

Over a year-and-a-half period, SFREI and its attorneys repeatedly and willfully deceived the district court by misrepresenting the facts material to the issue of personal jurisdiction over SFREI. Based on its misrepresentations, SFREI was successful on *two* motions to dismiss and in opposing one motion to reargue on the ground of lack of personal jurisdiction. *Bolton* v. *Gramlich*, 540 F. Supp. 822, 844-45 (S.D.N.Y. Jan. 28, 1982); *Terrydale Liquidating Trust* v. *Gramlich*, 549 F. Supp. 529, 530-31 (S.D.N.Y. July 29, 1982); (unreported order, Sept. 14, 1982).[3] SFREI and its attorneys submitted affidavits, motions and briefs falsely representing that SFREI had not transacted any business whatsoever

[3] These dismissals occurred in the predecessor action to this case; petitioner was given leave to file a new complaint.

in New York and that the subject transaction occured entirely outside New York.[4]

Contrary to SFREI's sworn assertions, SFREI's New York counsel Skadden Arps had played a critical role in the subject transaction. In November 1982, when petitioner sought discovery from Skadden on this matter, Skadden moved for a protective order arguing that discovery of Skadden was irrelevant and harassing to Skadden and SFREI. When the district court ultimately ordered Skadden to comply with discovery requests, TLT discovered that *Skadden had executed two critical agreements in New York on behalf of SFREI that were essential to consummation of the subject transaction*. In addition, Skadden lawyers conducted negotiations and drafted an underlying asset purchase agreement in New York on behalf of SFREI.

Thereafter, SFREI did not renew its motion to dismiss on jurisdictional grounds. Nevertheless, in its answer to this action signed in September 1983 by Skadden and Landels Ripley, SFREI still asserted that the court lacked personal jurisdiction. Skadden and SFREI continued to assert the frivolous defense throughout trial. The court, after trial, ruled that personal jurisdiction existed over SFREI (16a) and that SFREI's defense was "entirely devoid of merit". *Terrydale Liquidating Trust* v. *Barness*, No. 82-7920, slip. op. at 4 (S.D.N.Y. April 15, 1987).

Significantly, all of the foregoing facts are undisputed.

C. SFREI's and Skadden's Secret Agreement To Pay $50,000 In Attorneys' Fees for the Witnesses

In December 1982 the former trustees of TRT, Michael Gramlich and James Kostoryz settled with TLT. TLT continued

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[4] For example, SFREI's President, Edgar Chappell, swore by affidavit in July 1981 that SFREI had "not transacted any business within New York in *any manner whatsoever*, including any business connected with the ... transactions which are the subject of this case." (emphasis added). SFREI's attorneys adopted this and other false affidavits in their briefs and at oral argument, knowing that these were not the true facts. At that time, SFREI was represented by the California firm, Landels, Ripley & Diamond, and the New York firm Rogers & Wells.

the litigation against SFREI. A condition precedent to SFREI's liability as constructive trustee was a finding that the TRT trustees had breached their fiduciary duty or Declaration of Trust.

On motion for summary judgment, the district court held that SFREI's liability as constructive trustee could not then be resolved because of numerous fact issues.[5] The stage was clearly set for a trial in which the former TRT trustees would be the key witnesses.

Against this background, SFREI and its attorneys, Skadden Arps, secretly agreed before trial to pay the attorneys' fees incurred by the former trustees and by others in the Gramlich family in preparing for and representing them at trial. Specifically, SFREI agreed to relieve petitioner's key witnesses of a $50,000 liability — without telling the court or petitioner of this deal. Significantly, the existence of the agreements is now beyond dispute. *See* (145a, 158a, 160a)(affidavits of the attorneys for SFREI and the witnesses attesting to the agreements and the payments).

In its August 26, 1986 post-trial opinion in favor of SFREI, the court relied very heavily on the testimony of the former TRT trustees (22a, 23a, 24a, 33a, 34a, 40a, 43a, 55a, 56a).

D. Post-Trial Motions

On August 29, 1986, SFREI moved for an award of attorneys' fees against TLT, as successor-in-interest to TRT, pursuant to a contract executed by SFREI and TRT containing a provision for reasonable attorneys' fees and expenses to "the prevailing party" in litigation between them. The court found TLT liable for SFREI's attorneys' fees and permitted SFREI to file an itemized

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[5] These issues included (1) a breach of the duty of loyalty by the former trustees based on the alleged self-interest of the Gramlich trustees and Stamper and the Gramlichs' control and domination of the other trustees; (2) a breach of the duty of care by the former trustees determined by whether the trustees were properly informed about the values of the buildings in deciding to sell to SFREI and liquidate the trust; (3) a breach of Declaration of Trust Provision Art. III Sec. 14 requiring a majority vote of the non-Gramlich trustees based on whether Stamper was self-interested and the other trustees were controlled and dominated by the Gramlichs; and (4) SFREI's notice of any of the aforementioned breaches.

fee request. *Terrydale Liquidating Trust* v. *Barness*, 645 F. Supp. 920, 925 (S.D.N.Y. 1986). After denying SFREI the attorneys' fees and expenses it had incurred on a limited number of issues, including its personal jurisdiction defense which the court found meritless, the court requested SFREI to submit a supplemental application.

In opposition to that application, TLT formally moved for (i) discovery in contemplation of a motion for new trial because of the prejudice it suffered at trial from the suspected illegal agreement between SFREI and the witnesses; (ii) sanctions against SFREI and its lawyers under Fed. R. Civ. P. 11 (and other provisions) for misconduct in connection with its baseless jurisdictional defense; and (iii) elimination of SFREI's fees in their entirety based upon SFREI's and its attorneys' egregious misconduct and deception of the court as delineated in (i) and (ii) (141a and 143a). In its opposition papers in August 1987, SFREI admitted the agreements and submitted the affidavits of Douglas M. Kraus of Skadden Arps (145a), Steven Umin of Williams & Connoly (158a), and David Welte of Polsinelli, White & Vardeman (160a). The lawyers for the *first time* (approximately one year after trial but before final judgment) admitted they had orally and *secretly agreed before trial* that SFREI would pay the fees and expenses of the two law firms representing the seven key witnesses called by petitioner.

By orally denying petitioner's motion for discovery (195a), the district court prevented petitioner from re-examining the witnesses in light of the agreements and from examining the witnesses' lawyers regarding their pretrial agreements and dealings with SFREI, and from testing Skadden's bald assertions that the payment was not contingent upon the witnesses' testimony. The court allowed petitioner until the next morning to move orally to set aside the judgment and for a new trial (198a). The district court orally denied plaintiff's motion, saying that the result of the trial would have been the same, regardless of the agreements and payments, and that knowledge of the agreement would not have altered its evaluation of the witnesses' credibility (214a). The court so held notwithstanding that its post-trial opinion heavily

relied on these witnesses' trial testimony (22a, 23a 24a, 33a, 34a, 40a, 43a, 55a, 56a). On appeal, the Second Circuit affirmed (1a).

REASONS FOR GRANTING THE PETITION

I. The Petition Raises Questions of Paramount Public Importance

Beyond all doubt, this case represents an extreme departure from the normal course of judicial practice. If it does not -- and if it is standard operating practice for litigants, and their attorneys, secretly to pay the attorneys' fees for their adversary's witnesses or to misrepresent and omit critical facts — this Court must surely rectify the situation. The petition raises the issue of whether an appellate court can countenance a judgment and award of attorneys' fees where a party and its attorneys secretly tamper with an adversary's witnesses and deliberately and repeatedly misrepresent to the court. By allowing respondent to retain its trial judgment, the decision below ignores the fact that the judgment was impermissibly tainted by the nondisclosure of an agreement, negotiated by respondent and its attorneys (officers of the court), which agreement grossly undermined the credibility of the witnesses. By awarding respondent its attorneys' fees, the decision signals the message to these litigants and attorneys, and to all others, that witness tampering and defrauding the court will be tolerated and compensated.

Measured by any standard—ethical, professional, indeed criminal—the course of conduct outlined herein is repugnant to the litigation process. SFREI's promise (through its attorneys) to pay $50,000 in legal fees to the attorneys who coached and represented witnesses called by petitioner cast a cloud over the trial and judgment that cannot be dissipated without a new trial. The prejudicial effect of the agreements and the failure to disclose them is obvious. The existence of the agreements made the testimony of the Gramlichs and of the "independent" trustees, and indeed SFREI's entire presentation, inherently unreliable.

In connection with respondent's frivolous jurisdictional defense, the repeated misrepresentations to, and withholding of material facts from, the court for over one and a half years are nothing less than outrageous. Such intentional deception cannot

be condoned in any manner. The failure to strike the entire request for fees amounts to approval of serious misconduct.

II. Counsel's Tampering With The Impartial Functioning Of The Judicial Process Through A Secret Agreement To Pay The Attorneys' Fees For The Adversary's Witnesses Is A Fraud On The Court Mandating That The Judgment Be Set Aside.

No doubt, Skadden's secret agreement for SFREI to pay the attorneys' fees for petitioner's critical witnesses constitutes a fraud on the court: "a fraud perpetrated by officers of the court so that the judicial machinery cannot perform in the usual manner its impartial task of adjudging cases that are presented for adjudication. . . ."7 *Moore's Federal Practice* para. 60.33 at 60-360 (2d ed. 1987) (footnote omitted). Because the witnesses affected were critical to petitioner's case, the conclusion is inescapable that the misconduct and testimony were highly material.

The integrity of the judicial process requires that a judgment obtained by a deliberately planned and carefully executed scheme to defraud the district court and petitioner be automatically vacated. Accordingly, the rulings below must be reversed for the same reasons stated in *Hazel-Atlas Glass Co.* v. *Hartford-Empire Co.*, 322 U.S. 237 (1943):

> Tampering with the administration of justice in the manner indisputably shown here involves far more than an injury to a single litigant. *It is a wrong against the institutions set up to protect and safeguard the public,* institutions in which fraud cannot complacently be tolerated consistently with the good order of society. . . The public welfare demands that the agencies of public justice be not so impotent that they must always be mute and helpless victims of deception and fraud.

Id. at 246 (emphasis added).

Here the secret agreement of respondent and its attorneys to pay the attorneys' fees for witnesses called by petitioner was deliberately designed to destroy the neutrality of that testimony. Tampering with witnesses goes to the very heart of the administration of justice and must be condemned without qualification.

As is, the rulings below condone such direct witness payments as legal and proper. The lower courts' failure to condemn the misconduct of respondent's attorneys, Skadden Arps (one of the largest law firms in the country), at a minimum creates the appearance of impropriety, and more importantly grants a license to litigants and their attorneys to engage in blatantly illegal tampering with witnesses resulting in an impermissibly tainted judgment. Thus, the judgment below should be vacated and a new trial granted.

The fraud herein is as egregious as the fraud in *Hazel-Atlas* where the lower court had "*both the duty and the power to vacate its own judgment.*" 322 U.S. at 250 (emphasis added). In *Hazel-Atlas*, the undisputed evidence revealed a "deliberately planned and carefully executed scheme to defraud. . . the Circuit Court" and "under settled equitable principles, [that required] the interposition of equity to devitalize the. . . judgment." 322 U.S. at 245, 247. The petition *sub judice* similarly cries out for an order vacating the judgment and "*a complete denial* of relief" sought by the litigant guilty of fraud. 322 U.S. at 250 (emphasis added).

The impropriety and illegality of an agreement to pay $50,000 to an adversary's witnesses in the form of attorneys' fees are beyond dispute. Federal policy regarding federal witnesses is clear from 18 U.S.C. Sec. 201(c)(2) which prohibits *all* payments direct or indirect in connection with testimony other than statutory witness fees such as for travel, subsistence and loss of time. Such payments should be timely disclosed to the trier of the facts, and counsel should be permitted to examine the effect of large payments upon the witness' credibility. *See, Fund of Funds, Ltd.* v. *Arthur Andersen & Co.* 545 F. Supp. 1314, 1369-1370 (S.D.N.Y. 1982). Thus, at a bare minimum the court and petitioner should have been apprised of the arrangement before trial.[6]

The payment by SFREI of the attorneys' fees of the seven witnesses relieved these witnesses of a $50,000 liability. There can

[6] Agreements to pay fact witnesses compensation in excess of statutory witness fees are void and contrary to public policy and thus unenforceable. *See e.g. Alexander* v. *Watson*, 128 F.2d 627, 630 (4th Cir. 1942).

be no question that by giving this gift (with or without conditions attached) SFREI curried favor with the witnesses.

Further, payment of a witness' attorneys' fees is actually more corrupt than a direct payment to the witness. Here the attorney who is preparing the witness for his testimony is being paid by one of the parties and thus becomes that party's hired gun, thus protecting that party's interests. Therefore, as these lawyers prepared the witnesses for trial and guided their testimony, they were motivated to protect SFREI. The very existence of the agreements secured the witnesses' favor; their lawyers who were paid by SFREI became partners with or agents of SFREI in promoting the SFREI strategy. The attorneys for SFREI and the witnesses were obligated to disclose to the court that the witnesses' attorneys were also representing respondent SFREI who was paying their fees.

Where the trial court relies significantly on the testimony of witnesses in making findings of fact and reaching conclusions of law, and it is thereafter revealed that their testimony has been tampered with by the adversary, the denial of a new trial constitutes reversible error. The credibility of the key witnesses that petitioner called to establish its case has been seriously impugned by the existence and nondisclosure of these unlawful agreements. Failure to grant a new trial where the testimony of key witnesses on critical issues has been impugned constitutes an abuse of discretion. *Harre* v. *A.H. Robbins Co., Inc.*, 750 F.2d 1501 (11th Cir. 1985). Petitioner relied on the testimony of the seven witnesses in presenting its case and after trial learned that their testimony was tainted. Significantly, the untainted testimony of the few other fact witnesses called by petitioner was collateral to that of the witnesses paid by SFREI. Further, the seven witnesses' testimony was not simply repetitive of documentary evidence. Thus, because the corrupt testimony was non-cumulative on key issues, the prejudice cannot be ignored.

The district court's opinion manifests its reliance on the testimony of the Gramlichs and other trustees in making findings of fact and reaching conclusions of law. In addition to the numerous instances in which Judge Sand directly references their testimony (22a, 23a, 24a, 33a, 34a, 40a, 43a, 55a, 56a,), the opinion reflects

that "intricate web of findings" that have been affected by the testimony. *Phillips* v. *Crown Central Petroleum Corp.*, 556 F.2d 702, 705 (4th Cir. 1977), *cert. denied*, 444 U.S 1074 (1980).[7]

Thus, notwithstanding his assertions to the contrary during his bench ruling on August 28, 1987 (200a, 211a-212a), Judge Sand did rely heavily on the testimony of the former TRT trustees. The record seriously impeaches the court's attempt one year later to trivialize the importance of the testimony (22a-24a, 33-34a, 40a, 43a, 55a-56a, *see* 200a-204a, 207a-212a). This Court has made clear that where the trial court relies on certain evidence, it can not disavow that reliance when it is shown after judgment that the evidence is untrustworthy. *Hazel-Atlas Glass Co.* v. *Hartford Empire Co.*, 322 U.S. 238 (1944). In *Hazel-Atlas*, after being apprised of an undisputed "sordid story" of deliberate fraud on the court, the lower court denied relief, in part because the fraud was not "basic" to its decision. On certiorari, the Supreme Court pierced this bald assertion, examined the lower court opinion, and *disagreed* with the court on its reading of its own opinion regarding materiality of the evidence:

> Whether or not it was the primary basis for that ruling, the article did impress the Court, as shown by the Court's opinion.

322 U.S. at 246-247. Likewise, the opinion of the district court in this case manifests its reliance on the now tainted testimony. The Second Circuit opinion similarly confirms the critical importance of the testimony of the former TRT trustees. That court affirmed the district court's numerous findings of fact which were based on the tainted testimony of the trustees (1a-9a).

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[7] Moreven, on a motion for summary judgment, the district court ruled that the testimony of the TRT trustee witnesses was essential to decide key issues in the case (64a, 82a-92a; *see also* 96a-98a, 125a, 126a-127a n.23-n.24, 132a-133a).

III. The Award Of Attorneys' Fees Of $1.5 Million To Respondent Should Be Stricken. A Litigant And Its Attorneys Who Have Flouted Their Obligations To The Court By Tampering With Witnesses And Misrepresenting Material Facts To The Court Should Not Be Rewarded.

The award of attorneys' fees and expenses to respondent, notwithstanding the egregious misconduct by it and its attorneys, rewards litigants and their attorneys for engaging in blatantly illegal tampering with witnesses and for repeatedly misrepresenting critical facts to the court. Allowing a litigant to recover under a contractual provision as "the prevailing party", where its victory was seriously tainted by corruption and deception on the court, violates the integrity of the judicial process. SFREI has forfeited any claim to reimbursement for attorneys' fees and expenses because both SFREI and its attorneys grossly defaulted in their obligations of honesty and fair play with the court.

Given the repeated instances in which respondent and its attorneys tampered with the judicial process, the rule of law must *require* that the attorneys' fees be denied completely in these circumstances. Litigants and lawyers—large and small—must be aware that if they flagrantly flout their obligations to the court, they will not be rewarded by reimbursement for their attorneys' fees incurred along the way. The award of $1.5 million in attorneys' fees invites and rewards surreptitious tampering with witnesses and blatant deceptions.

In *Hazel-Atlas Glass Co.* v. *Hartford Empire Co.*, 322 U.S. 238 (1943), this Court announced that upon proof that a successful litigant with the help of its attorneys had perpetrated a fraud on the court, the court had a *duty* to vacate the judgment *and deny all relief. Accord: Keystone Driller Co.* v. *General Excavator Corp.*, 290 U.S. 240, 246 (1933), and *Precision Instrument Manufacturing Co.* v. *Automotive Maintenance Machinery Co.*, 324 U.S. 806, 814 (1945).

As a sanction for pretrial misconduct, in failing to answer interrogatories, this Court in *National Hockey League* v. *Metropolitan Hockey Club, Inc.*, 427 U.S. 639 (1976), upheld the dismissal of the complaint. The misconduct in *National Hockey League* is benign when compared to the flagrant fraud in this case.

National Hockey reminds the courts that sanctions including dismissal are necessary for punishment and deterrence:

> [T]he most severe in the spectrum of sanctions provided by statute or rule must be available to the District Court in appropriate cases, not merely to penalize those whose conduct may be deemed to warrant such a sanction, but to deter those who might be tempted to such conduct in the absence of such a deterrent.

427 U.S. at 643. Likewise, dismissal of SFREI's claim for attorneys' fees is a necessary and appropriate sanction[8]

The petition *sub judice* involves respondent's and its attorneys' fraud on the court—their repeated, deliberate deception and concealment of facts conclusively establishing personal jurisdiction and their secret tampering with the petitioner's key witnesses. Thus, "[t]he *total effect of all this fraud,. . . calls for nothing less than a complete denial of relief. . .* " to respondent. *Hazel-Atlas Glass Co., supra,* 322 U.S. at 250 (emphasis added).

In sum, the decisions below grant respondent and its attorneys an exemption from the law as it allows them to engage in serious misconduct and to flout obligations of honesty and full disclosure to the court. They have obtained a judgment tainted thereby and they have been rewarded with an award of over $1.5 million in attorneys' fees. The decisions below doubly reward the litigant who, with its attorneys, has flouted the rules of law, by (1) allowing it to retain its judgment on the merits and (2) granting it attorneys' fees.

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[8] Indeed, *National Hockey League* has been construed as *requiring* dismissal of plaintiff's claim where it has flouted its obligations to the court. *Dellums* v. *Powell*, 566 F. 2d 231 (D.C. Cir. 1977) held that in a class action, it was an abuse of discretion for the district court to reinstate its prior dismissal of plaintiffs' complaint for the failure to comply with discovery. If for no other reason than the prophylactic considerations indentified in *National Hockey League*, this misconduct cannot be tolerated in federal litigation. *Dellums*, 566 F. 2d at 235. *National Hockey League* warns that leniency regarding misconduct creates bad law as it encourages "other parties to other lawsuits" to flout their obligations to the court. Where there are intentional and blatant frauds on the court, more so than where there is a failure to comply with discovery, the district court must deny all relief.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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September 9, 1988

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Appendix A

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

No. 793—August Term 1987

Argued: April 7, 1988 Decided: May 12, 1988

Docket No. 87-7867

TERRYDALE LIQUIDATING TRUST,

Plaintiff-Appellant,

—v.—

HERBERT BARNESS, JOHN F. BISHOP, EDGAR H. CHAPPELL, CHARLES W. CORBITT, GEORGE S. MANN, BROOKS WALKER, JR., LOUIS W. WALKER, and CHARLES M. WILLIAMS, individually and as Trustees of, and DAVID R. BRYANT as Trustee of SAN FRANCISCO REAL ESTATE INVESTORS, and KEITH L. BROWN, individually, and as SAN FRANCISCO REAL ESTATE INVESTORS, INC.,

Defendants-Appellees.

SAN FRANCISCO REAL ESTATE INVESTORS, INC., a Delaware corporation, successor in interest to San Francisco Real Estate Investors, a California real estate investment trust,

Counterclaimant and Third-Party Plaintiff,

—v.—

TERRYDALE LIQUIDATING TRUST, a New York business trust: TERRYDALE REALTY TRUST, a Missouri business trust: OLIVER R. GRACE, OLIVER R. GRACE, JR., EMILIO G. COLLADO, WILLIAM BOLTON, and ROBERT A. POSNER, individually and as trustees of TERRYDALE LIQUIDATING TRUST; J. RUSSELL GRAMLICH, J. HARLAN STAMPER, THOMAS J. MURPHY, JOHN D. O'FLAHERTY, and JOHN J. GRAMLICH, individually and as trustees of TERRYDALE REALTY TRUST; LINCOLN TOWER BUILDING CO., a Colorado partnership, SUBDALE CORPORATION, a New York corporation, MORRIS, LARSON, KING, STAMPER & BOLD, a Missouri professional corporation, HARRY A. MORRIS, ROY A. LARSON, THOMAS E. KING, J. HARLAN STAMPER, LAWRENCE R. BOLD, LYNN C. HOOVER, DONALD H. LOUDON, GORDON N. MYERSON, STEVEN H. GOODMAN, TOMMY W. TAYLOR, LAURENCE R. TUCKER, DAVID M. RHODES, ROBERT B. KEIM, JACK W. ISLEY, JR., THOMAS R. LARSON, STEVEN G. EMERSON, GREGORY M. KRATOFIL, JOHN A. KOEPKE, and JOHN R. COCKLE, individually and as partners of MORRIS, LARSON, KING, STAMPER & BOLD,

Counterclaimant and
Third-Party Defendants.

Before:

OAKES, MINER, *Circuit Judges*,
and POLLACK, *District Judge.**

---

* Honorable Milton Pollack, Senior United States District Judge for the Southern District of New York, sitting by designation.

Appeals from summary judgment order dismissing claim of aider and abettor liability of purchaser of real estate assets of trust, sold in alleged breach of fiduciary duty of trustees; and from dismissal after trial of claim for restitution from purchaser as constructive trustee; and from incidental rulings and orders made during the litigation.

Affirmed.

SIDNEY BENDER, Garden City, NY (Aaron Lewittes, Janine L. Bender, Leventritt Lewittes & Bender, of Counsel), *for Plaintiff-Appellant.*

REX E. LEE, Washington, DC (Gene C. Schaerr, David Orentlicher, Sidley & Austin, of Counsel), *for Plaintiff-Appellant.*

DOUGLAS M. KRAUS, BARRY GARFINKEL, New York, NY (Erskine D. Henderson, Mitchell C. Sockett, Skadden, Arps, Slate, Meagher & Flom, of Counsel), *for Defendants-Appellees.*

PER CURIAM:

This appeal grows out of six years of litigation stemming from an unsuccessful struggle in 1981 for control of a registered Missouri real estate investment trust, Terrydale Realty Trust ("TRT").

On January 9, 1981, BCG Associates ("BCG"), a New York partnership, made an unsolicited tender offer for 34.7% of the shares of TRT, offering $33.50 per share, in cash. The purpose of the offeror was to obtain control of TRT. Had the shares been acquired under the offer, when added to the 17.9% interest already owned by BCG's principals, it would have given BCG absolute control of TRT. Allowing for proration of tendered shares, the TRT stockholders would have had only a small amount of their shares purchased for cash, with the remainder being returned to them.

The trustees, believing that the tender offer was not acceptable, sought to obtain a better offer from BCG, viz., an agreement on its part to acquire 100% of TRT's shares at the $33.50 price, but BCG refused to amend its offer to include all shares to TRT. The trustees would not have opposed BCG's tender had it been for all of the TRT shares.

There were substantial disadvantages for TRT's stockholders apparent in BCG's partial offer, including loss of TRT's favorable tax status, a probable decline in marketability of its shares, and possibly cessation of its status as a reporting company under the Federal Securities Laws, among other things.

The trustees, two of whom were also substantial shareholders, set about to seek more attractive alternatives for TRT's shareholders. They solicited bids from numerous corporate and real estate investors, including seven of the largest and most sophisticated realty investors in North America. The TRT trustees, in essence, put TRT up for "auction" to the highest bidder. None of the sources approached was willing to offer a transaction which would yield more than $33.50 to all TRT shareholders. Ultimately, the trustees turned to San Francisco Real Estate

Investors, Inc. ("SFREI"), and negotiations with the latter ripened into a proposal from SFREI to purchase TRT's four Denver office buildings, representing about 80% of the value of TRT's assets, a purchase to be made at prices set forth in recently obtained independent appraisals. None of the other potential White Knights was willing to make an offer as attractive as that of SFREI, and the District Court explicitly found that SFREI's offer was the best offer available.

TRT made the sale, and the trustees simultaneously voted to liquidate the trust and declared a liquidating dividend, thereby thwarting the tender offer. An initial liquidating distribution of $24 per share was declared. Over the next 12 months, a further $9.85 was distributed to TRT shareholders, bringing the total proceeds of the sale and liquidation to $33.85 per share for 100% of TRT's shares.

After the trustees' decision to sell and liquidate was announced, BCG extended its tender offer expiration date, and adjusted its offering price to $9.50 per share in order to take into account the $24.00 per share initial liquidating dividend. BCG acquired 80,884 shares pursuant to its extended tender offer, leaving it with approximately 38% of the outstanding TRT shares. During 1981, BCG continued to purchase TRT shares through a series of open market purchases. By January, 1982, BCG had apparently acquired just under 50% of the outstanding TRT shares.

On January 28, 1982, the TRT shareholders approved the creation of the Terrydale Liquidating Trust ("TLT"), the named plaintiff and appellant in this action, and elected as TLT trustees a slate of nominees controlled by the BCG group. BCG then caused TLT, newly controlled by what, in essence, was a defeated tender offerer, to be named plaintiff in this suit (1) against the former trustees

of TRT, charging that they sold the TRT property at distressed prices to defeat the tender offer in the service of personal interests of some of the trustees, and (2) against SFREI, the purchaser of the realty, alleging that it had aided and abetted the allegedly tainted sale, and in any event, that it had sufficient notice of the trustees' alleged breach of fiduciary duty to warrant the equitable claim of restitution from SFREI.

In December, 1982, TLT reached a settlement with the former TRT trustees under which TLT abandoned its lawsuit against them and SFREI remained as the only defendant in the lawsuit.

In June, 1984, SFREI made a motion for summary judgment, which the District Court granted in part and denied in part. 611 F. Supp. 1006, 1031, 1033 (S.D.N.Y. 1984). The Court found that there was no genuine factual issue in respect to plaintiff's claim that SFREI was an aider and abettor of the alleged breach of fiduciary duty of the trustees or to the alleged breach of the unanimity provision of the Declaration of Trust. The aider and abettor liability claim was therefore properly dismissed on summary judgment for TLT's failure to establish the key material issue, SFREI's actual knowledge. *Marine Midland Bank v. Smith*, 482 F. Supp. 1279, 1290 (S.D.N.Y. 1979), *aff'd mem.*, 636 F.2d 1202 (2d Cir. 1980). SFREI's constructive knowledge was an insufficient basis for recovery.

The Court denied summary judgment on an alleged domination and control issue pertaining to the trustees. The sale to SFREI required the approval of three of the five trustees, including two affirmative votes from among trustees Stamper, Murphy, and O'Flaherty. All trustees had voted to sell the assets, and the question raised

whether the votes were independent suggested the need of a factual determination, as stated by the Judge:

> Whether the affirmative votes of the non-Gramlich trustees [the three outsiders] were legally effective and valid, however, will depend on whether plaintiff can establish its claim of domination and control by the Gramlichs. The existence *vel non* of domination and control, and of SFREI's notice of same, involve factual determinations which prevent this Court from presently resolving the merits of plaintiff's restitutional claim.

611 F. Supp. at 1033 (footnote omitted).

After a 14-day non-jury trial in 1986, the District Court, in a comprehensive and well-reasoned opinion, dismissed TLT's remaining claims against SFREI on the merits. 642 F. Supp. 917 (S.D.N.Y. 1986).

In considering, evaluating, and determining to make the sale of the properties, the trustees were found to have measured up to the standard set in *Hanson Trust PLC v. ML SCM Acquisition Inc.*, 781 F.2d 264 (2d Cir. 1986), of reasonable diligence in gathering and considering material information. The "independent" trustees deliberated a period of days, not hours, before approving the deal. During that time, as the evidence showed, the trustees solicited extensively for bids for the assets or stock. Unlike *Hanson*, the TRT trustees were not presented with "more or less a *fait accompli.*" Rather, the trustees, with the assistance of their expert advisors, considered not just the SFREI proposal, but all available alternatives, and the independent trustees had called a separate meeting on their own initiative at which they gave separate consideration to the available options; they properly concluded that only a deal struck with SFREI would benefit *all* shareholders.

The duty, indeed the obligation, of the TRT trustees under the circumstances of this case was to maximize the value for *all* shareholders, and Judge Sand had ample basis upon which to conclude that the trustees had met their duty of care. They were found to have sought, in the exercise of an informed business judgment, a solution which would benefit 100% of the shareholders of the trust, rather than leaving them to be forced into a minority position in an entity of which BCG had control, and with little hope of ever realizing the full value of their remaining investment in TRT. TLT never established a *prima facie* case for breach of the duty of loyalty or the duty of care and the burden to defend the transaction as fair and reasonable never shifted. *Norlin Corp. v. Rooney, Pace Inc.*, 744 F.2d 255, 264 (2d Cir. 1984); *Hanson Trust PLC*, *supra*, at 277.

The District Court rejected plaintiff's contention, as contrary to fact, that the Gramlichs had acted in self-interest and in bad faith; and it found that the non-Gramlich trustees had acted independently, reasonably, and were not dominated and controlled as alleged; and it found that all the trustees had properly exercised their duty of care. In voting for the sale under the proposal and the Plan of Complete Liquidation, it is clear that the trustees fully recognized that they were voting to give up their positions of control of TRT and any possible benefits that they might derive from the continued existence of TRT.

The Judge found further that no circumstances existed which would warrant imposition of a constructive trust, since there was an absence of SFREI's actual knowledge of any alleged breach by the trustees. Incident to this holding, the Judge resolved the facts as showing that the approval of the sale and the liquidation of TRT did not

violate the terms of TRT's Declaration of Trust; that the sale was under all the facts and circumstances reasonable; and that SFREI had no reason to investigate the actions of the trustees or to think that there was any breach by them.

The District Judge went into the values of the properties sold, giving careful consideration to and weighing the appraisal testimony, and found that the sales had been made within the current fair market value. SFREI's offer was found explicitly to be "the best offer available"; the Judge found that there was no "fire sale," as contended by the plaintiff, and that SFREI's expert had given credible and reliable testimony. On the facts and circumstances in evidence, the Court properly rejected the contrary hindsight appraisals of TLT's expert. At hand were accurate reflections of the property values, especially in view of the long-term leases held by a number of tenants. Significantly, SFREI, an independent outsider, had purchased the properties in an arm's-length, reasonable, commercial transaction.

The records on the motion for summary judgment and of the trial satisfy us that Judge Sand's factual findings thereon are not clearly erroneous; to the contrary, they are amply supported by the record and we agree with his conclusions and rulings on the law substantially for the reasons given by him therefor.

The requests for Rule 60(b) relief and Rule 11 sanctions are without any merit whatsoever. The other specifications of alleged error appealed from have each been examined and we find that there is no merit in them.

AFFIRMED.

Appendix B

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

SAME TITLE

FINAL JUDGMENT
82 Civ. 7920 (LBS)
#87, 1578

Upon the opinion of the Court dated November 19, 1984 granting in part defendants' motion for summary judgment, the Court's opinion after trial dated August 26, 1986, the Court's opinions dated October 24, 1986 and April 15, 1987, respecting reimbursement of attorneys' fees and expenses, and its bench rulings dated August 27, 1987, and upon all of the other papers filed and proceedings had herein, it is hereby ordered that Final Judgment be entered in this action as follows:

1. The claims of plaintiff Terrydale Liquidating Trust ("TLT") against defendant San Francisco Real Estate Investors, Inc. ("SFREI") and all of the other defendants herein are dismissed with prejudice.

2. The claims of SFREI against counterdefendants and third party defendants which have not previously been disposed of are hereby dismissed with prejudice.

3. SFREI shall recover from TLT, and TLT shall pay to SFREI, the sum of $1,453,847.10, representing SFREI's reasonable attorneys' fees and expenses through August 28, 1987, and SFREI shall further recover post-judgment interest on such sum at the rate specified in 28 U.S.C. § 1961 from October 24, 1986 in the amount of $69,663.51, for a total award of $1,523,510.61. SFREI shall further recover post-judgment interest on such total

award from the date hereof to the date of payment, pursuant to 28 U.S.C. § 1961.

* * * * * *

Dated: August 28, 1987
New York, New York

Leonard B. Sand
United States District Judge

Appendix C

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

SAME TITLE

JUDGMENT

A non-jury trial before the Honorable Leonard B. Sand, U.S.D.J. having begun on June 10, 1986, and at the conclusion of the trial the Court having reserved its decision; and the Court thereafter on August 26, 1986, having handed down its OPINION (#59760), dismissing the complaint, it is,

ORDERED, ADJUDGED AND DECREED: That the complaint be and it is hereby dismissed.

Dated: New York, N.Y.
August 28, 1986

Raymond F. Burghardt
Clerk

Appendix D

TERRYDALE LIQUIDATING TRUST, Plaintiff,

v.

Herbert BARNESS, et al., Defendants.

SAN FRANCISCO REAL ESTATE INVESTORS, INC., Counterclaimant and Third-Party Plaintiff,

v.

TERRYDALE LIQUIDATING TRUST, et al., Counterdefendants and Third Party Defendants.

82 Civ. 7920 (LBS).

United States District Court,
S.D. New York.

Aug. 26, 1986.

Leventritt, Lewittes & Bender, Garden City, N.Y., for plaintiff; Sidney Bender, Aaron Lewittes, Janine L. Bender, of counsel.

Skadden, Arps, Slate, Meagher & Flom, New York City, for defendants; Douglas M. Kraus, Erskine D. Henderson, Barry H. Garfinkel, Mitchell C. Sockett, of counsel.

SAND, District Judge.

Plaintiff, Terrydale Liquidating Trust ("TLT"), a New York business trust that is the successor in interest to Terrydale Realty Trust ("TRT"), brought an action against San Francisco Real Estate Investors, Inc. ("SFREI") and the individual trustees of San Francisco Real Estate Investors, seeking to hold them liable as aiders and abettors of an alleged breach of fiduciary duty and as constructive trustees of property allegedly sold to them in violation of the seller's fiduciary duties and Declaration of Trust. On November 19, 1984, this Court granted defendants' motion for summary judgment in part and dismissed the claim that they were aiders and abettors of said breach. *Terrydale Liquidating Trust v. Barness*, 611 F.Supp. 1006 (S.D.N.Y.1984) (hereinafter "*Terrydale*"). Both defendants' and plaintiff's motions for summary judgment as to plaintiff's equitable claim for restitution were denied, however, because material questions of fact existed as to whether there was a breach of fiduciary obligation or Declaration of Trust and, if so, whether defendants had sufficient notice thereby

such that they held the acquired assets as constructive trustees for plaintiff's benefit. *Id.* at 1012. On June 10, 1986, the action proceeded to trial. For the reasons stated below, we find that plaintiff also has failed to establish any liability on defendants' part with respect to plaintiff's claim for equitable restitution.

FACTS

This case presents, with some significant variations, what has become a common phenomenon in the securities field: efforts by management to resist and defeat hostile takeovers by enlisting the aid of a "white knight" or other inhibitory tactics. Here, the significant variations relate to both the nature of the target and the relief sought as well as the role defendants played in the subject transaction. First, the target was a Missouri Real Estate Investment Trust ("REIT") which, under relevant IRS provisions, would have lost its preferred tax status and other benefits if five or fewer of its shareholders owned 50% of its stock. Second, having settled its claims against the target's trustees and having had its claims for other relief dismissed, plaintiff

now seeks to impose upon the white knight—the entity that purchased most of its assets—a constructive trusteeship over those assets for the benefit of the target's shareholders. Plaintiff premises this claim on a theory that the purchaser knew or should have known that the sale constituted a breach of the TRT Declaration of Trust and of the target's trustees' fiduciary obligation to the target's shareholders. Plaintiff has succeeded in establishing that this Court has personal jurisdiction over the defendants and subject matter jurisdiction over plaintiff's claim for equitable restitution.

The facts underlying this litigation and its complex procedural history already have been articulated in several prior opinions. *See Terrydale,* 611 F.Supp. at 1012–1014; *see also Terrydale Liquidating Trust v. Gramlich,* 549 F.Supp. 529 (S.D.N.Y.1982); *Bolton v. Gramlich,* 540 F.Supp. 822, 827–30 (S.D.N.Y.1982). Familiarity with these prior opinions shall be assumed and the facts will be restated only to the extent necessary to set forth our findings of fact and conclusions of law pursuant to F.R. Civ.P. 52(a).

Briefly, BCG Associates (hereinafter "BCG"), a New York limited partnership, commenced an unsolicited tender offer for 160,000 TRT shares at a price of $33.50 per share. If successful, the offer would have given BCG virtual majority ownership of TRT. The TRT trustees decided to pursue alternatives to BCG's offer and "met or otherwise communicated with seven other bidders for the purpose of soliciting either a tender offer for all or part of the TRT shares or an offer to purchase the assets of TRT. The trustees also attempted, without success, to persuade BCG to amend its offer to provide for purchase of all outstanding TRT shares." *Terrydale*, 611 F.Supp. at 1013 (footnote omitted).

After a Canadian company, Unicorp Financial Corporation, decided not to enter into the battle for control of TRT, its president, George Mann, notified SFREI (40% of whose stock was owned by Unicorp) of the TRT opportunity. SFREI eventually proposed to purchase approximately 80% in value of TRT's assets (*i.e.*, four office buildings located in Denver, Colorado) after originally expressing interest in acquiring all of the outstanding TRT shares.

Several meetings of the TRT trustees followed. First, they met as a group on February 2, 1981, to consider the SFREI proposal and other alternatives to the BCG tender offer. The "independent trustees," *i.e.*, those who were not members of the Gramlich family, met on February 5 and concluded that the SFREI offer was in the best interests of all the TRT shareholders. All of the TRT trustees unanimously approved the sale of the Denver properties to SFREI on February 6 and, in addition, adopted and disclosed a liquidation plan whereby the proceeds of the SFREI sale would be distributed to TRT shareholders along with the remaining trust assets. A liquidating dividend of $24 per share would also be distributed on February 23 to all the TRT shareholders of record as of February 19.

1. *Breach of Fiduciary Duty*

In our most recent opinion involving this litigation, we determined that the business judgment rule/duty of loyalty analysis was applicable to the trustees of a REIT. *Terrydale*, 611 F.Supp. at 1016. We also noted that plaintiff had submitted sufficient evidence to create issues of fact regarding

the self-interest of trustees John Gramlich, J. Russell Gramlich, and J. Harlan Stamper; the Gramlichs' domination and control over trustees Murphy, O'Flaherty, and Stamper (to the extent Stamper was not otherwise self-interested); and the fairness and reasonableness of the transactions at issue. *Terrydale*, 611 F.Supp. at 1019–32. Thus, for plaintiff to prevail in its remaining claim against defendants, it must prove by a preponderance of the evidence, that, under the applicable analysis, the TRT trustees breached their fiduciary duty.

Where business trustees have acted in good faith and have exercised honest judgment in lawful and legitimate furtherance of the trust's purposes, courts will neither inquire into nor interfere with their actions. *See Norlin Corp. v. Rooney, Pace Inc.*, 744 F.2d 255, 264 (2d Cir.1984) (quoting *Auerbach v. Bennett*, 47 N.Y.2d 619, 629, 419 N.Y.S.2d 920, 926, 393 N.E.2d 994, 999 (1979)).[1] This posture of respect is affiliated with the "duty of care" prong of the trustee's duty to the shareholders—*i.e.*, "the responsibility of a ... fiduciary to exercise, in the performance of his tasks,

the care that a reasonably prudent person in a similar position would use under similar circumstances." *Norlin, supra,* 744 F.2d at 264; *see also Hanson Trust PLC v. ML SCM Acquisition, Inc.,* 781 F.2d 264, 273 (2d Cir.1986). The duty of loyalty, the second prong of a trustee's obligation to shareholders, "derives from the prohibition against self-dealing that inheres in the fiduciary relationship." *Norlin,* 744 F.2d at 264. Once plaintiff has made a prima facie showing that the trustees had a self-interest in the subject transaction, "the duty of loyalty supercedes the duty of care, and the burden shifts to the [trustees] to 'prove that the transaction was fair and reasonable to the trust.'" *Norlin,* 744 F.2d at 265 (quoting *Treadway Companies, Inc. v. Care Corp.,* 638 F.2d 357, 382 (2d Cir.1980); *see also Hanson, supra,* 781 F.2d at 273.

The Second Circuit has recently written that "[i]t is not enough that [trustees] merely be disinterested and thus not disposed to self-dealing or other indicia of a breach of the duty of loyalty." *Hanson, supra,* 781 F.2d at 274. Rather, they also must meet the standard of due care "with 'conscientious fairness'"—*i.e.,* they must

make informed decisions after "gathering and considering material information" with "reasonable diligence." *Id.* (citation omitted). If they adhere to " 'methodologies and procedures' [that] are 'so restricted in scope, so shallow in execution, or otherwise so *pro forma* or halfhearted as to constitute a pretext or sham,' then inquiry into their acts is not shielded by the business judgment rule." *Id.* (quoting *Auerbach, supra*, 419 N.Y.S.2d at 929, 393 N.E.2d at 1002–003); *but see id.* at 285–91 (Kearse, J., dissenting).

Plaintiff alleges the two Gramlich trustees' self-interest as predicated upon desired continued management of the properties and the receipt of fees and commissions therefrom as well as their personal debt situation. Defendants seem to have conceded that the two Gramlich trustees were "interested" (*see* Letter of June 30, 1986 from Attorneys for Defendants at 6), but, more importantly, the remaining trustees perceived the Gramlichs to be "interested" and arranged to meet separately to discuss the SFREI transaction. *See, e.g.*, Tr. 484–85.

We note, however, that although plaintiff contends the Gramlichs' dire financial straits prompted their desperation to consummate the deal with the "white knight" which led to the sacrifice of the best interests of the shareholders (*see Terrydale*, 611 F.Supp. at 1020–21), this does not appear to have been the case. While it is true the Gramlichs had a $890,872 loan obligation falling due on February 10, 1981 (*id.*), J. Russell Gramlich testified that the payments on the note could have been met by turning the Gramlichs' stock over to BCG at the last moment if "[they] had no better offer for our stockholders." Tr. 1419–20. Michael Gramlich apparently "was in Kansas City with all [of the] stock ready to tender it to the Grace people in case this deal didn't go through with [SFREI]." Tr. 1431. Although this plan poses certain difficulties regarding John Gramlich's and Michael Gramlich's apparent ignorance of it (*see* Plaintiff's Supplemental Memorandum of Law of July 29, 1986 at 49–52 ("Plaintiff's Supp. Memo.")), the Gramlichs' prior announcement advising shareholders not to tender their stock, and possible short-swing profit problems,

15 U.S.C. § 78p(b), it at least indicates that the Gramlichs were not as "desperate" as plaintiff intimates. Moreover, J. Russell Gramlich also testified that his other investments could have helped cover the loan. Tr. 1419.

We also reject plaintiff's contention that the Gramlichs' self-interest and bad faith likewise were demonstrated by their decision to announce the consummation of the transaction no later than Friday, February 6, 1981. According to plaintiff, the documentation regarding rent adjustments supports its view that the closing did not take place until Monday, February 9, 1981. Pretrial Order at Exh. 3B ("Plaintiff TLT's Factual Contentions") ¶ 182; Tr. 602. Thus, the Gramlich trustees allegedly accelerated the announcement so that the TRT shareholders would know they would receive a liquidating dividend and thereby defeat the BCG tender offer. This acceleration also allegedly prevented BCG from seeking to enjoin further consummation of the closing because of the latter's belief that the entire deal had been finalized on February 6, 1981.

In fact, as Stamper testified, a title company acting as TRT's agent had received the proceeds of the sale on February 6, 1981 "and they had held it over the weekend because they had no means to transmit it until Monday." Tr. 595; 600–01. It was therefore TRT's position that it had the right to declare the dividend on February 6, 1981. Most importantly, however, on the facts of the case and the state of events at that time, it seems highly improbable that any court would have granted BCG injunctive relief.

Assuming the Gramlich's self-interest, though, "the Board *as a whole* cannot be charged with having acted from self-interest where less than a majority are found to have done so." *Buffalo Forge Co. v. Ogden Corp.*, 555 F.Supp. 892, 904 (W.D. N.Y.) (emphasis added) (citing *Treadway, supra*, 638 F.2d at 358), *aff'd*, 717 F.2d 757 (2d Cir.), *cert. denied*, 464 U.S. 1018, 104 S.Ct. 550, 78 L.Ed.2d 724 (1983); *but see Dynamics Corp. v. CTS Corp.*, 794 F.2d 250, 256 (7th Cir.1986) (a conflict of interest is not cured by vesting the power of decision in a board of directors in which insid-

ers are a minority). We are satisfied as a factual matter that of the non-Gramlich trustees, Stamper was not "improperly influenced by personal considerations or benefits not available to other shareholders generally" (*see Terrydale*, 611 F.Supp. at 1022 (citations omitted)) and Murphy, O'Flaherty, *and* Stamper were not so dominated and controlled by the Gramlichs that their independence and financial disinterest were overcome. *Id.* at 1022 (citing *Aronson v. Lewis*, 473 A.2d 805, 812 (Del.1984)). Although it was bad judgment to allow the personal attorney for the Gramlichs and TMC, James Polsinelli, Esq., to attend the independent trustees' meeting, we find that Polsinelli's presence at that meeting did not undermine the independent trustees' careful and objective consideration of the SFREI offer and their primary concern for the interests of all of the shareholders.[2] *See* text *infra*.

Lack of self-interest alone, as we already have noted, is not enough to satisfy a fiduciary's duty of care. In *Hanson*, *supra*, the Second Circuit reversed the district court's denial of a motion for a preliminary injunction restraining the exercise of a

lock-up option despite the fact that it agreed that the defendants had not acted fraudulently, in bad faith or out of self interest. 781 F.2d at 274. According to the court, what made out a prima facie case of a breach of the duty of care, shifting the burden of justification to the defendants, was the failure of the directors "to take many of the affirmative directorial steps that underlie the finding of due care." *Id.* at 275. For example, the directors had voted for the lock-up option with a "paucity of information" after a three hour meeting, thereby not availing themselves of the week's time available before the tender offer deadline. 781 F.2d at 271, 275. Moreover, if they had inquired into the value of the two optioned businesses (which generated half of the target's income but represented only one-third of the purchase price for the entire company) rather than "contented themselves with their financial advisor's conclusory opinion that the option prices were 'within the range of fair value,'" they would have learned that the range of fairness had not been calculated and Goldman Sachs had not even prepared a written opinion as to the

value of the two optioned businesses. *Id.* at 275. According to the Second Circuit, other things evidencing the improper exercise of due care included the fact that the target's principal financial advisor indicated that an "orderly sale" could achieve higher prices for the optioned businesse., no opinion had been offered as to what kind of company the target would be without these "core" businesses, and the Board had failed to ensure the negotiations of alternative bids and, in essence, rubberstamped a proposal engineered by management directors holding a potential 15% equity interest in the arrangement. *Id.* at 276–77; *see also id.* at 269–70.

This Court finds that in the instant case, the trustees properly exercised their duty of care. The Board in *Hanson* was faced with an unsolicited tender offer for "any and all shares of [the target's] common stock" for a price per share that was conditionally raised *twice* without the target's request during the course of leveraged buyout negotiations between the target and a third party. 781 F.2d at 270, 272. In contrast, the TRT trustees faced a partial tender offer replete with potential

disadvantages.[3] Like the Board in *Hanson*, the TRT trustees sought out other alternatives under tremendous time pressures; however, the latter also unsuccessfully sought to negotiate with the tender offeror for the purchase of *all* outstanding TRT shares while the former ignored the tender offeror's "overtures for discussions." *See* 781 F.2d at 269, 270.

Although discussions with SFREI did not develop into a final proposal until approximately February 5, 1981, the TRT trustees had been discussing the proposed asset sale as well as other alternatives since February 2, 1981. Thus, their unanimous vote for the final proposal on February 6, 1981 followed four days of consideration compared to the three hours in which the independent trustees in *Hanson* for the first time learned about and approved the new leveraged buyout merger agreement and the proposed lock-up option. 781 F.2d at 271; *see also Dynamics Corp., supra*, 794 F.2d at 256–257 (target's management announced its opposition same day unsolicited tender offer was announced *without* studying any business or financial implications of tender offer or consulting with target's

outside directors). Moreover, the transaction at issue in *Hanson* demanded the Board's "*heightened* duty of care" in order to ensure that one did not cross the critical line between a price low enough to lure a reluctant potential bidder and one lower than " 'reasonable permission w[ould] allow.' " 781 F.2d at 276 (emphasis in original) (citations omitted). Since no lock-up option was at issue in the instant matter, a "*heightened* duty of care" was not demanded.

Plaintiff emphasizes certain factors as evidencing the TRT trustees' breach of their duty of care. These factors relate to the Gramlichs' self-interest in defeating the BCG tender offer and how this self-interest allegedly led to a sacrifice of the property at distressed prices. *See* Plaintiff's Memorandum of Law Opposing Defendants' Motion to Dismiss, Under the Business Judgment Rule (June 27, 1986) at 7.[4] According to the Second Circuit in *Hanson*, to the extent that self-interest impacts upon the duty of care even after a court has determined that there was no fraud, bad faith or self-dealing, it calls upon independent trustees to take "at least some of the prophylac-

tic steps that were identified as constituting due care in *Treadway* [, *supra*]" when a self-interested management has made the proposal at issue. *Hanson*, 781 F.2d at 277. In *Hanson*, however, on top of its 15% equity interest, management was discussing a leveraged buyout with the investment banking concern ultimately hired as the Board's advisors *before* the Board first met to discuss the unsolicited tender offer, and it was management and these advisors who generated a response to the tender offeror's raised bid. 781 F.2d at 277. Confusion over whether the law firm Wachtell, Lipton, Rosen and Katz represented management or the Board, moreover, continued "[e]ven after [the firm] was formally retained by the Board." *Id.* Not only were none of these factors present in the TRT transaction, but the Gramlichs certainly did not present the independent trustees with the SFREI proposal "more or less as *faits accompli*, which [the independent trustees] then quite hastily approved." *Id.* The Gramlichs also did not do something that was appropriately criticized in *Dynamics Corp.*, *supra*, 794 F.2d at 256–257 —hire an investment advisor to prepare a

"fairness opinion" who was to receive a bonus if the tender offeror lost a proxy fight.

Even if the Gramlichs' alleged interests amounted to the same sort present in *Hanson*, a finding of a breach of the duty of care would not be warranted. In *Treadway, supra*, the directors, among other things, hired an investment banking firm to negotiate for them and to assist in evaluating the various proposals, asked numerous questions and requested pro forma balance sheets for the combined company, and conditioned their approval of the transaction on obtaining an opinion regarding its fairness. 638 F.2d at 384. Nowhere, however, have these actions been prescribed as the sole means by which this duty can be fulfilled. *See Dynamics Corp., supra*, 794 F.2d at 258 (particular methodology used by target to analyze tender offer would have been of "little moment" if the defensive tactic adopted had been acceptable because the court had "no desire to force boards of directors into a judicialized mode of proceeding and . . . recognize[d] the time pressure under which the board was operating").

Here, the independent trustees called a separate meeting pursuant to their own initiative. *See* text *supra*. They also knew that the cash each shareholder would receive was approximately the same under either proposal, but that only a deal struck with SFREI would benefit *all* the shareholders; [5] that no other "white knight" was willing to offer anything above this value; and that the BCG tender offer might not only wreak havoc with TRT's tax status but also could leave minority shareholders in a very disfavorable position. The independent trustees even considered revaluing the Denver properties and concluded that other problems would obviate the predictability and worth of new appraisals, Plaintiff's Exh. 14A (*e.g.*, the instability of the Denver market; the various encumbrances on the properties; etc.); moreover, the time exigencies created by the BCG tender offer mooted this possibility. Finally, by pledging their approval of the SFREI proposal, they did not foreclose further bidding for TRT. *See Hanson*, 781 F.2d at 264; *see also Dynamics Corp.*, *supra*, 794 F.2d at 258. In fact, the BCG tender offer was instead extended and adjusted to reflect

the liquidating dividend, by January, 1982, BCG had acquired just under 50% of the outstanding TRT stock, and a slate of BCG nominees was elected to serve as trustees of TLT when it was created on January 28, 1982. *Terrydale*, 611 F.Supp. at 1014.[6]

Even if we found that the TRT trustees had breached their duty of care, we would need to determine whether the shifted burden of proving the fairness and reasonableness of the transaction has been met. *See Hanson*, 781 F.2d at 277. We find that such is the case.

It should be noted at the outset that the idea of liquidating TRT was *not* first promulgated as a response to the BCG tender offer. John Gramlich had been suggesting liquidation "for a couple of years" (Tr. 205; *see also* Tr. 1264) in order to deal with a problem REITs collectively had been facing—the undervaluation of their stock. *See* Tr. 841; 1237–38; 1843. As Stamper testified at trial,

> [W]e had discussed whether there would come a time where we had a duty to the shareholders because of the underlying value to liquidate and give them their

> money back. The reason we had considered it more than a year before was because the value of our shares had gotten down to somewhere around 12 or 14 dollars, as I recall it, and we wondered whether it was fair to the shareholders to just continue giving them dividends at the level we were able to or whether we ought to actively consider selling the properties and giving them their money back and letting them reinvest in something else.

Tr. 564. Courts generally have treated challenged transactions that facilitate plans which were under consideration *before* anyone moved to acquire stock *more favorably* than those "cooked up" solely in response to contests for control. *See Norlin, supra,* 744 F.2d at 265 n. 7; *see also Treadway, supra,* 638 F.2d at 383; *Crouse-Hinds Co. v. Internorth,* 634 F.2d 690, 703–04 (2d Cir.1980). Thus, it does not "strain[ ] credulity" to discern merit in the SFREI transaction and subsequent TRT liquidation. *Norlin,* 744 F.2d at 265.

That such merit conceivably is present is buttressed by a comparison to *Joseph E. Seagram & Sons, Inc. v. Abrams,* 510

F.Supp. 860 (S.D.N.Y.1981). There, a tender offer prompted the board, once legal proceedings collapsed, to announce "a proposed buy-out of a small segment only of stockholders, using the corporate till to accomplish this at a price [$15 per share above the tender offer price] and with a preferred stock issue in the background...." 510 F.Supp. at 861. A "frenzied search for a competitive third party offer" had not as yet panned out and "a proposed selling off of the assets was in contemplation by a plan to seek the sale of [the target's] attractive properties, ... one of ... which yield[ed] 10% of the corporate earnings, and to raise more cash to buy in more stock in that way with the company's treasury." *Id.* at 861–62. In issuing a temporary restraining order sought by the tender offeror, Judge Pollack opined that "[i]t [wa]s inconceivable that an alleged flourishing enterprise ha[d] authorized its board to subject ... the company to a scorched earth policy ... merely to thwart a change in existing stock ownership which may end the tenure of the present directors and key officers of the company." *Id.* at 861.

Plaintiff has attempted to show that the sale of the Denver properties was not fair to TRT and its public shareholders because the buildings were grossly undervalued. Specifically, plaintiff has alleged that the June 1980 appraisal of the Lincoln Tower Building prepared by Blain Chase understated its true value as $18,000,000. Plaintiff claims that this undervaluation was evidenced by the November 1982 sale closing of the same building by Lincoln Tower Building Company (when values in the Denver office building market were lower) to Subdale Corporation for $26 million. Plaintiff also points to Chase's "Preliminary Revaluation" of the fee in the amount of $24 million on February 2, 1981. Plaintiff further claims that Chase, *inter alia*, utilized in his June 1980 report a capitalization rate that was too high and an economic rental rate that was too low.

With respect to the Petroleum Building, sold to SFREI for $6,713,000, plaintiff claims that the revised appraisal of Van Court & Company (October 1980) overlooked both a significant change in rental rates and the sale of the Lincoln Center Building, the same sale that had prompted

Chase's "Preliminary Revaluation" of the Lincoln Tower Building. Plaintiff also claims that the market in February 1981, when TRT sold the Petroleum Building, was no different than that in December, 1981, when SFREI did a property analysis and evaluation of its leasehold interest in the building and valued it at $12,400,000 ("almost double what it paid TRT"); Joseph J. Blake & Associates received and concurred with SFREI's estimate of current fair market value. Plaintiff's Exh. 62.

As to the Travelers Building (also known as the "101 University Building"), sold to SFREI for $2,485,000, plaintiff first claims that TRT itself admitted in January, 1981 that it appraised the building to Mid American Bank at $4 million. Plaintiff also claims that the May 1980 Van Court & Company appraisal was obsolete as of February, 1981 due to the fact that the entire building became vacant on July 31, 1980, allowing SFREI to lease the entire building at the then higher current market rates. Finally, plaintiff once again compares the appraisal to SFREI's own December, 1981 property analysis and evaluation, with which J. Blake and Associates concurred,

valuing the leasehold interest at $4,950,000. Plaintiff's Exh. 48. With respect to the Century Bank Building, plaintiff also claims that TRT sold its fee interest at a price substantially below the building's fair market value.

Plaintiff's expert witness, Joseph Farber, MAI, CRE, also estimated the value of the leasehold estate interests in three of the subject properties as of February 6, 1981. Mr. Farber concluded in his report that the values were as follows: (a) Lincoln Tower Building—$17,150,000; (b) Petroleum Building—$11,750,000; (c) Travelers Building—$3,875,000. Plaintiff's Exh. 662 at 3. He also concluded that the value of the third mortgage owned by TRT against the Lincoln Tower Building was $6,930,000 and that the value of the leasehold estate interest in this same building may have increased somewhat by the later April 22, 1981 date. *Id.*[7]

We find that the burden of justification for the transaction has been met primarily by the introduction of "evidence to rebut [plaintiff's] extensive evidence that the [building] prices were undervalued." *Hanson*, 781 F.2d at 277. The Court's role, of

course, is not to ascertain "the 'precise value' " of the buildings. *Id.* at 278; *cf. Alpert v. 28 William St. Corp.*, 63 N.Y.2d 557, 483 N.Y.S.2d 667, 675, 473 N.E.2d 19, 26 (1984). Rather, it is to determine whether the burden of proving that the SFREI transaction was fair and reasonable has been met. For example, in *Lewis v. S.L. & E., Inc.*, 629 F.2d 764 (2d Cir.1980), a shareholder's derivative suit where it was alleged that the corporation's assets were wasted, the Second Circuit held that defendants had failed to prove that the rental paid for the years 1966–72 was fair and reasonable. However, although it noted that defendants' own evidence supported plaintiff's suggested fair rental value, the Court *never* determined for its own purposes the precise rental rate. *Id.* at 772.

With respect to the valuation of the four Denver properties sold to SFREI, this Court is convinced that the marketplace at that time was its most faithful indicator. First, the trustees never quarreled with the fairness of the BCG price of $33.50 per share and would have approved the tender offer if they had been successful at convincing BCG to make it available to *all*

TRT stockholders. *See, e.g.*, Tr. 144–45; 147; 195–96; 500; 698; 702; 1249–50. Second, in Murphy's words, "at least seven sophisticated investors [refused] to pay more than, at least offer [sic] $33 and a half a share." Tr. 148; *see also* Tr. 707–08, 752, 1246–48. As one of the defendants' expert witnesses testified, a "spotlight" was on TRT as early as December, 1981 when the Grace people filed a 13D form, soon followed by a proxy fight and tender offer. Tr. 1813 (testimony of Jeffrey Bloomberg, Managing Director of Bear Stearns & Co.). These events indicated to the world at large that a public company was "in play and anyone interested in acquiring assets for [sic] the company is alerted that the assets or the company will be available and starts to make inquiry." Tr. 1814. Thus, under such circumstances, interested parties tend to surface and the offers tend to approximate the current fair market value. Tr. 1850.

We also do not find any merit in plaintiff's contention that John Gramlich's search for a deal at $35 per share (knowing he would have "to settle somewhere in between 35 and 33.50," Tr. 811) effectively

proscribed higher offers. Tr. 1484. Not only were four of the trustees themselves in the real estate business (*i.e.*, the Gramlichs, O'Flaherty, and Murphy), making it extremely doubtful that they would be unaware of the trust's "unburied treasure" (*see* text *infra*), but if the value of the stock was as high as plaintiff projects, SFREI would not have been the only bidder.

In *Hanson, supra*, where one of the businesses was optioned at $350 million, "one of the first potential 'white knight' leveraged buyout firms ... contacted ... valued [that particular business] at about $550 million as part of its consideration as to whether it would make a tender offer...." 781 F.2d at 279. No such evidence from other prospective bidders was adduced here. In fact, the principals of BCG themselves declined to bid for the very building (Lincoln Tower) plaintiff now claims was worth at least $24 million when the Lincoln Tower Building Company offered it to them for approximately $19 million on or about February 17, 1981 (the latter was prepared to first exercise its option to acquire the building from SFREI).

Pretrial Order at Exh. 10B(i) ("SFREI's Proposed Findings of Fact Relating to Plaintiff's Claims Against SFREI") ¶¶ 148–49; Tr. 1032–35; *see also* Letter from Defendants' counsel of July 24, 1986 at 8–9.

Defendants' own expert witness, E. Nelson Bowes, MAI, CRE, reviewed the appraisals for the four Denver properties on which the sale price was based and concluded that they were reasonable both at the time they were rendered *and* on February 6, 1981. We agree with Bowes' conclusion. With respect to the Lincoln Tower Building and Blain Chase's February, 1981 "Preliminary Revaluation," we agree that even if one were to characterize it as a new appraisal, others knowledgeable in real estate may have found it inappropriate to apply the capitalization rate that had been utilized to appraise the Lincoln Center Building, a newer, different class building (*i.e.*, class A, while Lincoln Tower was class B)[8] situated in a better location. Thus, whatever plaintiff's explanation is for Chase's subsequent retraction from his February, 1981 "Preliminary Revaluation," (Pretrial Order at Exh. 3B ("Plaintiff TLT's Factual Contentions") ¶ 102; *see also* Chase Dep. of

May 16, 1984), the bottom line is that it was reasonable for the TRT trustees that knew about it (*see, e.g.*, Tr. 82, 88–89, 556, 816, 829, 832, 835–37; *contra* Plaintiff's Supp. Memo. at 1–12) not to have relied upon it. In fact, Stamper, John J. Gramlich and J. Russell Gramlich all testified that even if the Lincoln Tower Building had been worth $24 million in February, 1981, they would have voted for the SFREI sale (primarily because it took *all* of the shareholders out for the most money then offered). *See* Tr. 556–57, 837–39, 1447; *see also* text *infra*.

Plaintiff's criticisms of the methodology and numerical data (*e.g.*, for rental and capitalization rates, Plaintiff's Exh. 662) used in the original appraisals of all of the buildings also have been adequately addressed by the defendants (*see generally* Defendants' Exh. U (Bowes' Appraisal Review Four Buildings); Tr. 1872–1986) and changes in the Denver rental market from the appraisal dates up until February 6, 1981 seem to have only either compensated for earlier overvaluations or made minor differences in the ultimate price. Moreover, what impresses this Court most with respect to the validity of these original

appraisals is that neither the appraisers nor the owners themselves, who were valuing their own property, had any motivation to misstate the value. *See* Tr. 1882 (Farber himself "did not think that there was any intention of any of these appraisers to in any manner, shape or form come to a conclusion that was made as instructed by a client").

Compared to what the *Hanson* court found raised a serious question that the assets had been significantly undervalued, the criticisms voiced here, even if justified, seem minor. *See Buffalo Forge, supra*, 555 F.Supp. at 905 (noting that valuations are not an exact science); *see also* Tr. 1883 (testimony of Joseph Farber) (stating that real estate appraisal is an art rather than a mathematical science). In addition to what already has been mentioned, the target's principal advisor in *Hanson* (its investment banker at Goldman Sachs) himself testified that he had utilized tonnage, " 'a lousy way to value' " one of the optioned businesses and had employed a very significant measure of valuation, expected *earnings*, with "the two lowest actual and projected earnings years in a ten-year sequence." 781

F.2d at 278. Moreover, using his own firm's valuation charts and applying what he considered appropriate price-earnings ratios at the evidentiary hearing, he valued one of the target's divisions at a minimum of $70 million above the price it had been optioned for. *Id.* at 279; *see also id.* at 280 n. 10. With regard to the other division optioned in the *Hanson* transaction, " 'no document was produced in discovery which reflect[ed] a valuation or divestiture of [it] at less than $100 million prior to the grant of the Lock-Up Option;' " nonetheless, it was optioned for $80 million. *Id.* at 270, 280; *see also Dynamics Corp., supra,* 794 F.2d at 258–259 (criticizing poison pill that, among other things, burdened the target with a new, long-term fixed debt and precluded a hostile tender offer).

Probably what is most indicative of the fairness of the SFREI transaction relates to the Gramlich trustees' 30% equity interest in TRT. As Bloomberg testified, the situation at hand did not involve "professional management [which generally] has a different axe to grind; [rather, what was involved was] a trustee group that ha[d] a great economic interest in maximizing the

value for all shareholders." Tr. 1822; *see also* Tr. 1810. If the assets were truly undervalued, the Gramlichs would have been forfeiting a tremendous sum of money for nothing in return—*i.e.*, "the sale to San Francisco didn't carry a golden parachute or long-term employment contract so that [the Gramlichs] would get money as opposed to other shareholders." Tr. 1810, 1822. There is thus lacking a motivation for allegedly underselling the shareholders. In essence, the interests of the rest of the shareholders were on a par with those of the Gramlichs and everyone concerned received the same benefits from the liquidation.

BCG's own refusal to extend its offer to 100% of the available shares or effectuate any "second step" or "back end" transaction to acquire the shares not purchased pursuant to the tender offer adds support to this conclusion. See Tr. 1803–04. So does the uncertainty of the remaining alternatives. For instance, plaintiff contends that an orderly liquidation in the year following the tender offer would have maximized the return to TRT shareholders. However, there was no guarantee that BCG

would choose to liquidate following a successful tender offer; it had previously refrained from committing itself to such a course of action and even a decision to subsequently liquidate may not have been to the remaining shareholders advantage. Tr. 1805; Defendants' Exh. W (Jeffrey Bloomberg's Opinion Letter) at 8. If the TRT trustees had made their own announcement urging shareholders to reject the BCG offer in lieu of a planned liquidation one year down the line, moreover, defeat of the partial tender offer was equally unlikely. Tr. 1801–02, 1849; *see also* Defendants' Exh. W at 7; *Dynamics Corp., supra*, 794 F.2d at 254; Lowenstein, *Pruning Deadwood in Hostile Takeovers: A Proposal for Legislation*, 83 Colum.L. Rev. 249, 254, 307–09 (1983). Its success would have resulted in a loss of REIT status and the resulting diminished value of the company as well as a fall in the stock's market price. *See* Defendants' Exh. W at 5–6.

This is *not* an instance where the trustees " 'end[ed] the auction with ... little objective improvement' " or wanted SFREI "in the picture at all costs." *Hanson, su-*

pra, 781 F.2d at 283 (quoting *MacAndrews & Forbes Holdings, Inc. v. Revlon*, 501 A.2d 1239, 1249 (Del.Ch.), *aff'd*, 505 A.2d 454 (1985)). Rather, the trustees selected the best offer available at a time when some immediate action was mandated. *See Buffalo Forge, supra*, 555 F.Supp. at 904.

We have scrutinized the transaction with great care because we recognized that certain of its attributes rendered it superficially suspect—*e.g.*, the willingness of defendants to purchase the Lincoln Tower Building subject to a right of first refusal; the seller's request that the buyer render an opinion as to the TRT trustees' ability to conduct the transaction. *See, e.g.*, Tr. 1300–01; 1320–23; 1391. Nevertheless, in our view, the transaction has been justified by the fact that the values at which the properties were sold to SFREI were fair and reasonable and the way it served other important trust and shareholder interests. *See Norlin*, 744 F.2d at 267; *see also* Defendants' Exh. W at 6 and text *supra*; *Terrydale*, 611 F.Supp. at 1025; *Alpert, supra*, 483 N.Y.S.2d at 676, 473 N.E.2d at 27 (transaction must have involved not only fair dealing and fair price, but must have

treated all shareholders equally). Unlike the action taken by the directors in *Hanson*, this action, viewed in its entirety, "redound[ed] to the benefit of [TLT] and its shareholders." *Hanson*, 781 F.2d at 281.

2. *Knowledge of Breach of Fiduciary Duty*

Even if the TRT trustees had breached their fiduciary duty, a duty of restitution could be imposed on SFREI only if the latter knew or should have known that a breach had been committed. *Terrydale*, 611 F.Supp. at 1031. In other words, the defendants can only be held liable as constructive trustees of the transferred properties if they knew or should have known that a breach of fiduciary duty had occurred. *Id.* at 1032.[10]

At trial, we noted the burden that would be imposed by holding a purchaser "chargeable with all that goes on in the inner councils of the seller" simply by virtue of the fact that the former either has made a bargain purchase or is aware of the seller's distress. Tr. 765; *see also Terrydale*, 611 F.Supp. at 1030–31. However, this is a bridge we need not cross as we are convinced that if the values of the TRT

properties were such common knowledge that anyone operating in the market would or should have known of them, TRT would have been able to obtain an offer at a higher price than that proposed by SFREI. As we have already rejected other explanations offered for the market's silence, we conclude that SFREI cannot be presumed to have known that the TRT trustees had breached their fiduciary duty.[11]

Other factors also lead to this conclusion. As we noted earlier, defendants made certain "uncontradicted assertions establish[ing] the basis for their belief in the reasonableness of the transaction from TRT's point of view" (*Terrydale*, 611 F.Supp. at 1029)—*e.g.*, legitimate reasons for opposing the BCG tender offer; its offer to purchase TRT's assets was higher than any other offer on a per share basis; instability of the Denver market and risks associated with acquiring the TRT properties derived from " 'due on sale provisions,' necessary renovations, [and] long-term leases at unfavorable rents." *Id.* Thus, to the extent, if any, that defendants were required to make an inquiry,[12] they fulfilled their duty and came up with sufficient

facts to reasonably conclude that the trustees had not breached any duty and that SFREI's purchase of the assets would be legitimate. *See* Pretrial Order at Exh. 10B(ii) ("SFREI's Proposed Conclusions of Law Relating to Plaintiff's Claims Against SFREI") ¶¶ 112–24 and cases cited therein.

Finally, we have previously noted that the Restatement (Second) of Trusts "provides appropriate and helpful guidance in resolving the issue of notice." *Terrydale*, 611 F.Supp. at 1031 n. 44:

> Among the circumstances which are or may be of importance are the following: (1) whether he knows that the person with whom he is dealing is in fact a trustee; (2) the extent to which he has reason to believe that the person with whom he is dealing is or may be a trustee ...; (3) the character of the property dealt with, whether it is land or a chattel or a chose in action, negotiable or non-negotiable; (4) whether the transaction is one in the ordinary course of the business of the trustee; (5) whether the trustee is disposing of the property for much less than its real value; (6) whether the third person knows or has reason

> to believe that the trustee is dealing with the property for his own benefit; (7) whether the third person is purchasing the property or engaging in some other transaction with the trustee, as for example where he is making a payment or conveyance to the trustee . . . or is acting as depository of trust funds . . . or is a corporation registering a transfer of securities . . . or is engaged in some other dealings with the trustee. . . .

Id. (quoting Restatement (Second) of Trusts § 297, Comment a (1959)).

As defendants point out, factor 5 is absent as "this is not a case in which the disparity in price is so overwhelming and absence of legitimate business purpose so evident that knowledge of irregularity can reasonably be presumed." *Terrydale*, 611 F.Supp. at 1030–31 (citation omitted); *see also* Pretrial Order at Exh. 10B(ii) ("SFREI's Proposed Conclusions of Law Relating to Plaintiff's Claims Against SFREI") ¶ 121. In fact, Joseph Farber's testimony confirmed that even if the valuations were understated, they were not *so* understated as to inadvertently put any purchaser on notice. Rental, vacancy and

operating expense rates within ten percent of those utilized by Farber, a margin of error he himself found acceptable, could lead to appraisal values closely approximating those obtained by TRT's original appraisers. *See* Tr. 1957; 1974. Farber also articulated that "there is room for question in every appraiser's interpretation of the marketplace" (Tr. 1882) and that it was judgment, neither competence nor methodology, which separated his own figures from those derived by Blain Chase and Van Court & Company. Tr. 1877, 1881; 1883–84. Finally, we already have determined that the market place was the best indicator of valuation and that it reflected the fairness of the price paid by SFREI. *Compare* instant case *with Rippey v. Denver United States National Bank*, 273 F.Supp. 718 (D.Colo.1967); *Estate of Rothko*, 84 Misc.2d 830, 379 N.Y.S.2d 923 (1975), *decree modified and otherwise aff'd*, 56 A.D.2d 499, 392 N.Y.S.2d 870, *aff'd*, 43 N.Y.2d 305, 401 N.Y.S.2d 449, 372 N.E.2d 291 (1977).

Defendants also note that "the TRT trustees were not dealing with the Denver principals for their own account (factor 6)

... and ... SFREI was negotiating 'an arm's length commercial transaction' in which [it] had 'an independent duty to obtain the most favorable terms' (Factor 7)." Pretrial Order at Exh. 10B(ii) ("SFREI's Proposed Conclusions of Law Relating to Plaintiff's Claims Against SFREI") ¶ 121; *see Terrydale*, 611 F.Supp. at 1030; 1032–33. Thus, the inquiry outlined by the Restatement (Second) of Trusts provides additional support for our conclusion that defendants should not be held to have known that the TRT trustees breached their fiduciary duty (if one assumes that said breach has been established).

Conclusion

For the foregoing reasons, this Court finds that by voting for the transaction with SFREI and the liquidation plan, the TRT trustees breached neither TRT's Declaration of Trust nor the fiduciary duty they owed to the REIT's shareholders. Even if they had breached this duty, there would have been no basis upon which to conclude that the defendants should have known that such a breach had occurred and thus held to be constructive trustees of the

subject properties.[13] In short, we conclude that, lacking actual knowledge of any breach (*see* note 10 *supra*), no circumstances existed here (*e.g.*, extreme undervaluation of assets) which would warrant imposition of liability as a constructive trustee. Complaint dismissed.

SO ORDERED.

1. *See also Wolgin* v. *Simon*, 722 F.2d 389, 393 (8th Cir.1983). As we already have concluded, Missouri law is applicable in the instant case. *Terrydale*, 611 F.Supp. at 1015. However, "[t]o the extent that no directly applicable Missouri precedents exist," we utilize the law from other jurisdictions for guidance. *Id.*; *see also id.* at 1018.

2. We also find credible the independent trustees' testimony on this matter. Murphy, for instance, testified that he did not recall Polsinelli having made any comments and that his presence had not at all affected Murphy's thinking. Tr. 160, 191. O'Flaherty, who himself called for the meeting, testified that Polsinelli had asked Stamper whether or not he could attend the meeting and that Stamper told Posinelli it would probably be all right. Tr. 510. O'Flaherty, in line with his duty as chairman of the meeting, questioned Polsinelli's presence, but "had great trust in Mr. Stamper's judgment."

Id. O'Flaherty also did not recall Polsinelli's making any particular statements at the meeting. *Id.; see also* Tr. 512. Although Stamper "signed the minutes for the meeting which said, 'As the attorney for the Gramlich family, Mr. Polsinelli believed that the Gramlichs would have preferred that the trust purchase Stern warrants' " (Tr. 750), he, too, considered Polsinelli's presence "immaterial." Tr. 678, 682.

Moreover, we note that even if the comments made by Polsinelli at this meeting accurately portray his role as one of urging adoption of the SFREI plan, our conclusion remains unaltered. *See* Plaintiff's Exh. 14A (in addition to what is stated above regarding the Stern warrants, Polsinelli commented twice during the meeting that other potential buyers would not pay what SFREI was offering and stated once that they had to "take a hard look at whether or not we should liquidate").

3. In fact, in *Hanson*, the Board seems never to have made any determination regarding the advantages or disadvantages of the unsolicited tender offer. *See* 781 F.2d at 268. In the month before the tender offer was first announced at a price of $60 per share, moreover, the target's stock was trading at below $50 per share. *Id.*

4. The Court reserved decision on defendants' motion on June 30, 1986. Tr. 1489.

5. Plaintiff alleges that in *Dynamics Corp., supra,* the Seventh Circuit rejected a similar justification proffered by management. There, CTS's contention that the tender offer could not be considered fair when Dynamics was seeking only 17.9 percent of the shares was rejected because (a) since Dynamics already owned 9.6 percent of the shares, every fifth shareholder would get the price it now offered, and (b) all the shareholders benefited *ex ante* due to the fact that the announcement of the tender offer caused the stock's price to rise. *Dynamics Corp., supra,* 794 F.2d at 257. The Seventh Circuit did admit, however, that "some stockholders would not have known about the movement in the price and some who did know would adhere to a buy-and-hold strategy, and so not sell." *Id.* Finally, as we already have noted, all of this would have been of "little moment" to the Seventh Circuit if the adopted defensive tactic had been "a plausible measure for maximizing shareholder wealth." *Id.*

6. Since we have held that the independent trustees were not so dominated and controlled by the Gramlichs that their affirmative votes for the SFREI transaction and the liquidation plan were rendered invalid, we conclude that the sale to SFREI was not in violation of TRT's Declaration of Trust, Article III, § 14. *Terrydale,* 611 F.Supp. at 1012, 1032–33; *see* note 10 *infra.*

7. *See also* Plaintiff's Memorandum of Law Covering SFREI Liability and Duty of Restitution of July 17, 1986 at note 7.

Plaintiff also alleged at trial that the availability of below-market financing on the properties added value to the transaction and should have been recognized in the cash component of sales proceeds received by the seller. Plaintiff's Exh. 663 (Report prepared by David Kaplan, Senior Vice President of The Harlan Company, Inc.); *see also* Tr. 1540–43. It is unlikely, however, that after negotiating with a lender over potential assumption of a mortgage with a due on sale clause (negotiations involving payment to the lender, thereby raising the interest rate) that the buyer would reward the seller with a higher purchase price. Tr. 1543–46. More importantly, however, buyers could choose to take what they would have to pay up front to assume the mortgage to open a CD and utilize the considerable interest so generated. *See* Tr. 1560–65. Down the road, those buyers could refinance at a more favorable rate, *id.*; thus, they would still have the lump sum available to them that others who had purchased the below-market financing could never recoup. Tr. 1568.

8. According to Mr. Farber, there is no definitive description of class A and class B buildings and what is usually meant when these terms are utilized is how a given building competes with others "of the same genre on the same floor plate and the same elevating [sic] system." Tr. 1997–98 ("the basic definition of a class A building is how does his rent compare with his competition"). He also stated that the age of the building would not preclude it from falling into the class A category and that the Lincoln Tower

Building, although constructed in 1965, was a class A building. Tr. 1998–99.

Although we accept that this may be the viewpoint of some appraisers, we cannot find any reason to criticize the viewpoint of others in the real estate business who *do* see age as one of the decisive factors in valuation. Moreover, it appears that it was not only the class differential which led defendants' expert, E. Nelson Bowes, to conclude that the Lincoln Center Building was not a good comparable for the Lincoln Tower Building. *See* Defendants' Exh. U at 16–17; Tr. 1645–47; 1653.

9. Plaintiff intimates that the management fees and commissions received by TMC after the asset sale and liquidation (*Terrydale*, 611 F.Supp. at 1019) were a "material benefit" not available to other shareholders. *See* Pretrial Order at Exh. 3B ("Plaintiff TLT's Factual Contentions") ¶ 19; *see also* Tr. 1822. However, if the properties were truly valued as plaintiff alleges, the Gramlichs would have suffered a tremendous loss by opting instead for these fees and commissions. Moreover, one of defendants' experts testified at trial that he had "looked at the fees involved [and] these people were not overpaying themselves when they adopted the plan of liquidation." Tr. 1822 (testimony of Jeffrey Bloomberg).

10. In our most recent prior opinion, we noted that SFREI's actual knowledge of a breach of

duty must be proven in order to sustain plaintiff's claim of aiding and abetting. *Terrydale*, 611 F.Supp. at 1027. We dismissed the claim because no genuine issue had been created "regarding SFREI's alleged knowledge of the unfairness and lack of business purpose surrounding the sale and liquidation transaction." *Id.* at 1028. Furthermore, since we have concluded that there was no violation of TRT's Declaration of Trust (*see* note 6 *supra*), defendants cannot be held as "constructive trustees" under the theory that they "should have known" that the independent trustees were dominated and controlled by the Gramlichs, rendering their votes for the transaction invalid. *Terrydale*, 611 F.Supp. at 1033. Thus, in order to impose a duty of restitution on SFREI, plaintiff really must prove that SFREI should be presumed to have known that a breach of fiduciary duty had been committed. *See* Pretrial Order at Exh. 10B(ii) ("SFREI's Proposed Conclusions of Law Relating to Plaintiff's Claims Against SFREI") ¶ 109.

11. Our conclusion would be the same whether or not we accepted plaintiff's contention that under Missouri law, "defendants have the burden of proving that they took the properties with no notice of the breaches of trust." *See* Plaintiff's Memorandum of Law Covering SFREI Liability and Duty of Restitution of July 17, 1986 at 22 and cases cited therein; *but see* Pretrial Order at Exh. C ("SFREI's Contentions with Respect to Disputed Factual Matters") ¶ 5 (alleging that plaintiff bears burden of proof on issue of defendant's constructive notice).

12. *See* Restatement (Second) of Trusts, § 297, Comment a—

> "A third person has notice of a breach of trust not only when he knows of the breach, but also when he should know of it; that is when he knows facts which under the circumstances would lead a reasonably intelligent and diligent person *to inquire* whether the trustee is a trustee and whether he is committing a breach of trust, and if *such inquiry* when pursued with reasonable intelligence and diligence would give him knowledge or reason to know that the trustee is committing a breach of trust."

(Emphasis added). *See* also text *infra*.

13. Because of this conclusion, we need not determine certain issues raised by the parties at trial—*e.g.*, whether individual SFREI trustees should be dismissed as defendants; if SFREI still had to pay for the value of the Lincoln Tower Building even though it was transferred pursuant to a 60–day option-to-purchase *and* SFREI made no profits on the sale.

Appendix E

TERRYDALE LIQUIDATING TRUST, Plaintiff,

v.

Herbert BARNESS, John F. Bishop, Edgar H. Chappell, Charles W. Corbitt, George S. Mann, Brooks Walker, Jr., Louis W. Walker, and Charles M. Williams, individually and as Trustees of, and David R. Bryant as Trustee of, San Francisco Real Estate Investors, and Keith L. Brown, individually, and San Francisco Real Estate Investors, Inc., Defendants.

SAN FRANCISCO REAL ESTATE INVESTORS, INC., a Delaware corporation, successor in interest to San Francisco Real Estate Investors, a California real estate investment trust, Counterclaimant and Third-Party Plaintiff,

v.

TERRYDALE LIQUIDATING TRUST, a New York business trust; Terrydale Realty Trust, a Missouri business trust; Oliver R. Grace, Oliver R. Grace, Jr., Emilio G. Collado, William Bolton, and

Robert A. Posner, individually and as Trustees of Terrydale Liquidating Trust, Counterdefendants and Third-Party Defendants.

No. 82 Civ. 7920 (LBS).

United States District Court,
S.D. New York.

Nov. 19, 1984.

Leventritt, Lewittes & Bender, Garden City, N.Y., for plaintiff; Sidney Bender, Garden City, N.Y., of counsel.

Skadden, Arps, Slate, Meagher & Flom, New York City; Landels, Ripley & Diamond, San Francisco, Cal., for defendants; Douglas M. Kraus, Barry H. Garfinkel, Erskine D. Henderson, New York City, Harvey L. Leiderman, San Francisco, Cal., of counsel.

SAND, District Judge.

Plaintiff, Terrydale Liquidating Trust (hereinafter "TLT"), a New York business trust, brings this action against San Francisco Real Estate Investors, Inc. and the individual trustees of San Francisco Real Estate Investors, seeking to hold them lia-

ble as aiders and abettors of an alleged breach of fiduciary duty and as constructive trustees of property sold to them in violation of the seller's fiduciary duties and Declaration of Trust.[1] Defendants have moved for summary judgment pursuant to F.R.Civ.P. 56. Plaintiff has cross-moved for partial summary judgment pursuant to F.R.Civ.P. 56 on the issue of liability.

For the reasons detailed below and applying Missouri law, we conclude that, after extensive discovery, plaintiff is unable to show that defendants had actual knowledge of an alleged breach of fiduciary duty. We therefore grant defendants' motion for summary judgment in part and dismiss the claim that they were aiders and abettors of said breach. Concluding, however, that material questions of fact exist as to whether there was a breach of fiduciary obligation or Declaration of Trust and, if so, whether defendants had sufficient notice thereof such that they held the acquired assets as constructive trustees for plaintiff's benefit, we deny defendants' motion for summary judgment as to plaintiff's equitable claim for restitution. Plaintiff's motion for partial summary judgment is also denied.

FACTS

Plaintiff is a successor in interest to Terrydale Realty Trust (hereinafter "TRT"), a Missouri real estate investment trust[2] (hereinafter "REIT") which was the entity in existence at the time of the conduct at issue in this case. Defendant SFREI, Inc. was formerly a California REIT, known as San Francisco Real Estate Investors, whose acts (and the acts of its trustees) are relevant to the instant action. San Francisco Real Estate Investors and its trustees shall be collectively referred to as "SFREI."

The instant case arises out of the actions of TRT trustees taken in response to an unsolicited tender offer for TRT shares.[3] On January 9, 1981, BCG Associates (hereinafter "BCG"), a New York limited partnership in which third-party defendants William Bolton, Oliver Grace, Jr., and Robert Posner are general partners, commenced an unsolicited tender offer for 160,000 TRT shares, or approximately 34.7% of its outstanding shares, at a price of $33.50 per share. This offer, if successful, would have given BCG virtual majority ownership of TRT.[4] According to the BCG Offer to

Purchase, the offer was made in order to obtain control of TRT and to defeat proposed amendments to its Declaration of Trust. The offer was set to expire on February 10, 1981.

On January 19, 1981, the TRT trustees met to consider the BCG tender offer.[5] After discussing both the merits of, and a number of perceived problems with, the BCG offer, the trustees decided to continue to pursue alternatives to the offer. According to the minutes of a subsequent meeting of TRT trustees, TRT met or otherwise communicated with seven other bidders for the purpose of soliciting either a tender offer for all or part of the TRT shares or an offer to purchase the assets of TRT. The trustees also attempted, without success, to persuade BCG to amend its offer to provide for the purchase of all outstanding TRT shares.[6]

Just prior to this meeting of TRT trustees, TRT was contacted by George Mann, president of Unicorp Financial Corporation, a Canadian company which owned approximately 40% of SFREI. Mann expressed Unicorp's interest in making a tender offer for at least some portion of TRT shares.[7]

After considering the opportunity to bid for TRT shares, Unicorp decided not to enter into the battle for control of TRT. Mann, however, notified SFREI of the opportunity to acquire TRT shares.[8] Discussions ensued between representatives of TRT and SFREI. Although SFREI was initially interested in acquiring all of the outstanding TRT shares, SFREI eventually proposed instead to purchase approximately 80% in value of TRT's assets, specifically, four office buildings located in Denver, Colorado. The TRT trustees met on February 2, 1981 to consider the SFREI proposal, as well as to review various other alternatives to the BCG tender offer. An additional meeting of "independent" trustees, *i.e.*, those who were not members of the Gramlich family (*see* n. 5 *supra*), was held on February 5; at this meeting, the trustees concluded that the sale of the Denver properties to SFREI was in the best interests of all TRT shareholders. On February 6, the sale to SFREI was unanimously approved by all of the TRT trustees. In addition, the trustees adopted and disclosed a plan to liquidate the trust and to distribute the proceeds of the SFREI sale, along with the

remaining trust assets, to TRT shareholders. The trustees also announced that a liquidating dividend of $24 per share was to be distributed on February 23 to all TRT shareholders of record as of February 19.

After the trustees' decision to sell and liquidate was announced, BCG extended its tender offer expiration date to February 19 and adjusted its offering price to $9.50 per share in order to take account of the $24 per share liquidating dividend. BCG acquired 80,884 shares pursuant to its tender offer, leaving it with 208,629 shares, or approximately 38% of the outstanding TRT shares. During 1981, BCG continued to purchase TRT shares through a series of open market purchases. By January 1982, BCG had apparently acquired just under 50% of outstanding TRT shares. An additional liquidating dividend of $9.50 was distributed to TRT shareholders on January 12, 1982. On January 28, 1982, the TRT shareholders approved the creation of TLT [9] and elected a slate of BCG nominees to serve as trustees of TLT.[10] The instant lawsuit ensued.

Plaintiff's claims are essentially two-fold. First, plaintiff seeks to hold defendants civilly liable as aiders and abettors; specifically, plaintiff claims that the TRT trustees breached their fiduciary duties by selling and liquidating the trust property for allegedly self-interested reasons and at allegedly "fire sale" prices, and that SFREI knowingly and substantially assisted the trustees in this endeavor. Second, plaintiff seeks to hold defendants accountable as constructive trustees; specifically, plaintiff claims that the sale and liquidation, in addition to being tortious, were performed without obtaining the necessary approval allegedly required by the TRT Declaration of Trust, and that SFREI had "notice" of the TRT trustees' breaches of fiduciary duty and trust. As relief for the above claims, plaintiff seeks (1) an accounting from SFREI for losses suffered by TRT on the sale of TRT properties, damages, expenses and SFREI profits earned from the properties; and (2) a return to the "status quo ante." [11] On February 18, 1983, this Court denied defendants' motion to dismiss the complaint. On February 28, 1984, this

Court denied defendants' motion for summary judgment without prejudice to renewal upon completion of further discovery. Discovery was thereafter conducted during which numerous depositions were taken and numerous documents were produced. The instant motions ensued.

DISCUSSION

A. Applicable Law

A federal court exercising diversity jurisdiction must apply the substantive law of the forum in which it sits. *Erie R.R. Co. v. Tompkins*, 304 U.S. 64, 58 S.Ct. 817, 82 L.Ed. 1188 (1938). This includes the forum state's choice of law rules. *Klaxon Co. v. Stentor Electric Manufacturing Co., Inc.*, 313 U.S. 487, 61 S.Ct. 1020, 85 L.Ed. 1477 (1941). Since the instant case involves the activities of a Missouri real estate investment trust whose Declaration of Trust designated Missouri law as applicable, we conclude that Missouri law should be applied. *See Skolnik v. Rose*, 55 N.Y.2d 964, 434 N.E.2d 251, 449 N.Y.S.2d 182 (1982). To the extent that no directly applicable Missouri precedents exist, we shall refer to the law of other jurisdictions for guidance.

B. Standard of Review

Summary judgment may be granted only when it appears to the court that there is "no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law." Fed.R. Civ.P. 56(c). A court "cannot *try* issues of fact but can only determine whether there *are* issues of fact to be tried." *Katz v. The Goodyear Tire and Rubber Co.*, 737 F.2d 238, 244 (2d Cir.1984) (quoting *Empire Electronics Co. v. United States*, 311 F.2d 175, 179 (2d Cir.1962) (emphasis in original)). In addition, the court must resolve all ambiguities and draw all reasonable inferences against the moving party. *Id.* Thus, where "the party against whom summary judgment is sought comes forth with affidavits or other material . . . that generates uncertainty as to the true state of any material fact, the procedural weapon of summary judgment is inappropriate." *Id.* (quoting *Quinn v. Syracuse Model Neighborhood Corp.*, 613 F.2d 438, 445 (2d Cir. 1980)). Summary judgment is to be granted only where the court "is convinced as a matter of law that the suit can have only one possible outcome." *Reliance Insur-*

ance Co. v. Barron's, 442 F.Supp. 1341, 1344 (S.D.N.Y.1977).

C. Theories of Liability

1. *Aider and Abettor Liability*

[3, 4] A person may be liable, as an aider and abettor, for the tortious conduct of another if the person "knows that the other's conduct constitutes a breach of duty and gives substantial assistance or encouragement to the other so to conduct himself." Restatement (Second) of Torts § 876 (1982). Although Missouri courts have apparently not expressly adopted the Restatement formulation of civil aider and abettor liability,[12] this standard has been applied in other jurisdictions in cases involving alleged breaches of fiduciary duty, *see Marine Midland Bank v. Smith*, 482 F.Supp. 1279, 1290 (S.D.N.Y.1979), *aff'd*, 636 F.2d 1202 (2d Cir.1980); *Gilbert v. Bagley*, 492 F.Supp. 714, 735 (M.D.N.C.1980), common law fraud, *see Keller v. Coyle*, 499 F.Supp. 1031, 1033–34 (E.D.Pa.1980), *see also Kranzdorf v. Green*, 582 F.Supp. 335 (E.D.Pa.1983) (applying similar standard in fraud case), and securities fraud, *see Edwards & Hanly v. Wells Fargo Securities*

Clearance Corp., 602 F.2d 478, 483 n. 5 (2d Cir.1979); *Landy v. Federal Deposit Insurance Corp.*, 486 F.2d 139, 162–64 (3d Cir.1973), *cert. denied*, 416 U.S. 960, 94 S.Ct. 1979, 40 L.Ed.2d 312 (1974). Its use in the instant case is thus considered appropriate. Under this standard, plaintiff must demonstrate three elements in order to impose aider and abettor liability on SFREI: (1) a breach of fiduciary duty by TRT trustees; (2) knowledge of this wrongdoing by SFREI; and (3) substantial assistance or encouragement provided by SFREI to the TRT trustees. We will consider these elements in turn.

a. *Breach of Fiduciary Duty* [13]

In order to determine whether a breach of fiduciary duty has occurred, this Court must first determine the standard under which the TRT trustees' conduct should be evaluated. Specifically, we must determine whether the business judgment rule/duty of loyalty analysis—one which is frequently employed in evaluating the acts of corporate directors taken in response to an unsolicited tender offer or takeover bid—is applicable to the trustees of a REIT.[14] Mis-

souri courts do not appear to have addressed this issue.

For several reasons, this Court concludes that the business judgment rule/duty of loyalty analysis should be applied. First, a number of courts have applied the business judgment rule to the activities of REIT trustees. *See San Francisco Real Estate Investors v. REIT of America*, [1982 Transfer Binder] Fed. Sec.L.Rep. (CCH) ¶ 98,874, at 94,555–56 (D.Mass. Nov. 17, 1982) (enactment of by-law allegedly designed to limit concentration of REIT share ownership and block unsolicited tender offers), *aff'd in part and rev'd in part on other grounds*, 701 F.2d 1000 (1st Cir.1983); *see also Unicorp Financial Corp. v. First Union Real Estate Equity and Mortgage Investments*, 515 F.Supp. 249, 256 (S.D.Ohio 1981) (applying similar analysis to activities of REIT trustees); *cf. Hasan v. Clevetrust Realty Investors*, 729 F.2d 372 (6th Cir.1984) (termination of shareholder derivative action by REIT special litigation committee).

[6] Second, the trustees of a REIT are functionally more similar to corporate directors than to ordinary trustees. *See* 16A

Fletcher Cyclopedia of the Law of Private Corporations § 8249, at 619 (R. Eickhoff rev. ed. 1979). Indeed, whereas ordinary trustees are obligated to preserve and conservatively invest trust property, the profit-making responsibilities of a business trustee inevitably entail the exercise of business judgment similar to that of a corporate director. *See Plymouth Securities Co. v. Johnson*, 335 S.W.2d 142, 149 (Mo. 1960). The functional similarity and shared characteristics of business trusts and corporations—centralized management, transferable ownership in the form of shares, continuity of life, separate and distinct legal existence, a charter-like declaration of rights and obligations, and a profit-making purpose—has been recognized. *See Morrissey v. Commissioner*, 296 U.S. 344, 56 S.Ct. 289, 80 L.Ed. 263 (1935); *State Street Trust Co. v. Hall*, 311 Mass. 299, 41 N.E.2d 30, 33 (1942). A REIT in particular is, in all respects other than tax treatment, functionally indistinguishable from a corporation. *See* Stand.Fed.Tax Rep. (CCH) ¶ 4099F.015, at 46,493 (1982) (a REIT, "in addition to central management, must possess all other necessary attributes that would, except for REIT Code provisions,

cause it to be taxed as a corporation"). Based on these considerations, it is appropriate to judge the conduct of REIT trustees by the standards generally applied to corporate fiduciaries.

Third, the TRT Declaration of Trust is not inconsistent with the application of the business judgment rule/duty of loyalty analysis. The Declaration of Trust gives the trustees discretion substantially similar to that of corporate directors. *See* TRT Declaration of Trust, Art. III, § 1. In addition, the trust liability provision is similar to the Missouri business judgment rule. *Compare* TRT Declaration of Trust, Art. III, § 15 ("No Trustee shall be individually or personally liable to any Shareholder, other Trustee or any other Person for any errors of judgment or for any action taken or omitted in good faith ... Nothing contained in the Declaration, however, shall protect any Trustee against liability to the Trust, or the Shareholders for action taken or omitted by him in bad faith or for his willful misfeasance or reckless disregard of his duties or his own gross negligence.") *with Leggett v. Missouri State Life Insurance Co.*, 342 S.W.2d 833, 851 (Mo.1960)

(courts will not interfere with internal management of corporation except in cases of fraud, bad faith, breach of trust, gross mismanagement, or ultra vires acts). And although both the TRT Declaration of Trust and Missouri law indicate that a business trust is not a corporation, *see* TRT Declaration of Trust, Art. I, § 3; *Manufacturers' Finance Trust v. Collins*, 227 Mo. App. 1120, 58 S.W.2d 1004 (1933) (business trust, unlike corporation, need not acquire license to do business), these sources do not address either the standard to apply in examining the conduct of business trustees or the relevance of REIT status, as opposed to an ordinary business trust, in this regard.

Fourth, the challenged conduct in this case more closely resembles the conduct of corporate directors faced with an unsolicited tender offer, rather than a classic case of trustee malfeasance, *i.e.*, engaging in transactions with the trust on unfair terms and with self-interested motives. *Cf. Beedle v. Campbell*, 100 F.2d 798 (8th Cir.) (trustee's secret purchase of trust property deed constitutes breach of duty), *cert. denied*, 307 U.S. 631, 59 S.Ct. 835, 83 L.Ed.

1514 (1939); *Kotimsky v. Lubin*, 62 F.Supp. 710 (E.D.Ill.1945) (business trust promoter/director liable for breach of fiduciary duty based on non-arm's-length transaction with trust entered into for personal gain); TRT Declaration of Trust, Art. III, § 3(n) (dealings between trust and trustees governed by Missouri equity law regarding fiduciary obligations).

Finally, the practical similarity between the standards governing trustees and corporate directors has been recognized. Thus, when either directors or trustees engage in self-dealing or enter into a transaction in which they have a conflict of interest, the transaction will be upheld only if the fiduciary involved can demonstrate the fairness and reasonableness of the transaction. *See Morrissey v. Curran*, 650 F.2d 1267, 1274–75 & n. 7 (2d Cir.1981). To the extent that a stricter fiduciary standard may be appropriate in judging the conduct of business trustees, *see* 13 Am.Jur.2d *Business Trusts* § 61, at 424 (1964) (relationship between business trustees and beneficiaries is comparable to, but more confidential than, relationship between corporate directors and corporation); *see also*

McDaniel v. Frisco Employees' Hospital Association, 510 S.W.2d 752, 756–57 (Mo. Ct.App.1974), we believe that this notion may best be incorporated in our application of the business judgment rule analysis itself. *See* pages 1017–1027 *infra*. We will thus carefully look to determine whether the trustees have acted with disinterest and "scrupulous good faith," *McDaniel, supra*, 510 S.W.2d at 758, and if not, whether the challenged sale and liquidation transactions were fair and reasonable to the trust and its shareholders.

Although we are unable to find relevant Missouri precedent for judging the acts of directors or business trustees taken in response to an unsolicited takeover bid, the precedents governing the business judgment rule in general provide a helpful starting point. Under Missouri law, although courts will typically not interfere with the internal management of a corporation, they will do so where the directors or trustees act in bad faith or engage in fraud, breach of trust, gross mismanagement or ultra vires acts. *Leggett, supra*, 342 S.W.2d at 851; *Broski v. Jones*, 614 S.W.2d 300, 304 (Mo.Ct.App.1981) (courts

will not interfere where directors exercise business judgment fairly and honestly). Indeed, in circumstances involving the disposition of corporate assets or corporate dissolution, corporate fiduciaries are held to a standard of "scrupulous good faith in the fiduciary role as guardians of the corporate welfare." *McDaniel, supra,* 510 S.W.2d at 758 (trustees of incorporated nonprofit association); *Gieselmann v. Stegeman,* 443 S.W.2d 127 (Mo.1969) (directors are in position of "highest trust and confidence" and "utmost good faith" is required in exercise of powers). Consistent with this obligation, such fiduciaries cannot exercise their power in order to satisfy their own self-interest. *See Emergency Patient Services, Inc. v. Crisp,* 602 S.W.2d 26, 28 (Mo.Ct.App.1980) (directors prohibited from making "any self-serving disposition of [corporate assets] against the interests of the corporation"); *Johnson v. Duensing,* 351 S.W.2d 27 (Mo.1961); *accord Norlin Corp. v. Rooney, Pace Inc.,* 744 F.2d 255, 264–265 (2d Cir.1984); *Greer Inv. Co. v. Booth,* 62 F.2d 321, 325 (10th Cir.1932) (business trustees must manage assets for benefit of shareholders and not

"with an eye to their personal advantage or profits"). Such self-interest is demonstrated when directors or trustees enter into a transaction in order to acquire a benefit not shared by shareholders generally. *See Gieselmann, supra; Cheff v. Mathes*, 241 Del.Ch. 494, 199 A.2d 548, 554–55 (1964); *accord Buffalo Forge Co. v. Ogden Corp.*, 555 F.Supp. 892, 904 (W.D.N.Y.1983), *aff'd*, 717 F.2d 757 (2d Cir.), *cert. denied*, —— U.S. ——, 104 S.Ct. 550, 78 L.Ed.2d 724 (1983).

When fiduciaries act in furtherance of their own self-interest or for other improper motives, the duty of loyalty imposed upon fiduciaries requires them to demonstrate the fairness and reasonableness of their actions. *See Norlin, supra*, at 264–265.[15] Retention of control, while often a motive for directors' opposition to unsolicited takeover bids, is not the only illegitimate purpose which will shift the burden to the directors to justify their acts. *See Buffalo Forge, supra*, 555 F.Supp. at 904; *cf. Gieselmann, supra*, 443 S.W.2d at 136. Moreover, this self-interest need not be the sole motive for the fiduciaries' acts,

see Mobil Corp. v. Marathon Oil Co., [1981–1982 Transfer Binder] Fed.Sec.L. Rep. (CCH) ¶ 98,375, at 92,285 (S.D.Ohio Dec. 7, 1981), *rev'd on other grounds*, 669 F.2d 366 (6th Cir.1981); *Treadway Companies, Inc. v. Care Corp.*, 638 F.2d 357, 382–84 (2d Cir.1980), particularly where the alleged basis for self-interest is a readily identifiable and sizable financial interest, as in the instant case.[16] Under this standard, even if there are legitimate business reasons for the directors' acts, the director must demonstrate the fairness and reasonableness of a challenged transaction if the complaining party shows that the director was in fact motivated by self-interest in his or her conduct. *See Mobil, supra; cf. Buffalo Forge, supra*, 555 F.Supp. at 904.

Plaintiff advances several bases for a finding of trustee self-interest. These arguments will be discussed in turn for purposes of determining whether any issues of material fact remain with respect to plaintiff's claim.

Plaintiff alleges that trustees John Gramlich and J. Russell Gramlich acted in a self-interested manner by virtue of

the Gramlich family's ownership interest in, and control of, TMC, the manager of the trust properties.[17] Plaintiff has submitted sufficient evidence to create an issue of fact in this regard. TMC received $529,525 in management fees and commissions for the year ended September 30, 1981 and additional fees through February 5, 1982. Of the 1981 amount, $395,754 was received subsequent to the TRT sale and adoption of its liquidation plan; $283,254 was received in connection with the transfer of trust assets during the 1981 fiscal year. Plaintiff has produced some evidence to indicate that preservation of the TRT/TMC relationship was of concern to the Gramlichs. Although this concern was expressed primarily with respect to a proposed tender offer by Unicorp, a transaction that was never consummated, it still sheds light on the motives of the trustees at the time of the BCG tender offer.[18] Even the sale and liquidation plan eventually adopted by the trustees enabled the Gramlichs to preserve the TMC management relationship for almost a full year. Indeed, the TRT trustees had apparently discussed with SFREI the possibility that TMC would continue to

manage the trust properties; it is reasonable to infer that the Gramlichs foresaw or at least believed that this relationship's continuation was possible.[19] And although the amounts received by TMC prior to its termination as trust manager were admittedly less than that which it would have received had TRT continued in operation, the trustees may reasonably have foreseen a significantly more rapid termination of the TMC management agreement had BCG succeeded in gaining control of TRT. *See* Ex. A, SFREI's Requests for Admissions (BCG Offer to Purchase), at 11. The trustees' decision to sell the trust assets was apparently instrumental in defeating the BCG tender offer and thus avoiding immediate termination of the management agreement.[20] These circumstances and the reasonable inferences which can be drawn therefrom, combined with the motive or intent-based inquiry which is entailed in determining whether a director or trustee was sufficiently influenced by personal interests, create a triable issue of fact. *See Schwartz v. Marien*, 37 N.Y.2d 487, 335 N.E.2d 334, 373 N.Y.S.2d 122, 128 (1975). While we express no opinion as to the persuasiveness of this evidence of potential

self-interested conduct or of defendants' evidence to the contrary, issues of fact nevertheless remain.

Plaintiff further alleges that the Gramlichs' decision to oppose the BCG offer and sell TRT assets to SFREI was influenced by a $890,872 loan obligation falling due on February 10, 1981.[21] Plaintiff has produced evidence that the Gramlichs had insufficient assets to pay off the loan (or that they would have had to utilize relatively illiquid personal assets in order to discharge the loan obligation) and that the sale of TRT shares held by the lender as collateral was subject to SEC Rule 144's restrictions on the sale either of securities by "affiliates" of the issuer or of "restricted securities." There is some evidence to indicate that the ability of the Gramlichs to satisfy the loan obligation may have been of some concern to the bank, *see* Plaintiff's Ex. 262 (letter from Mid-American Bank to John Gramlich, Sept. 25, 1980); the deposition testimony of John Gramlich does not dispel all doubt as to whether this sizable loan obligation influenced the Gramlichs in their decision to oppose the BCG offer and

sell the trust assets. In addition, even if the collateralized shares were actually free of restrictions on their sale, it is presently unclear whether the Gramlichs were aware of this at the time of the challenged transactions. The existence of the loan obligation thus raises a triable issue of fact regarding the Gramlichs' alleged self-interest.

Defendants argue that the Gramlichs' loan obligation cannot be a basis for a finding of self-interest since the liquidating dividends paid by TRT were distributed equally to all TRT shareholders. Defendants contend that many TRT shareholders may have had outstanding loan obligations and that the trustees and non-trustee shareholders were thus similarly benefitted by the decision to sell and liquidate. It is true that a finding of self-interest is not warranted where the allegedly special benefits are available to all shareholders. *See Buffalo Forge, supra,* 555 F.Supp. at 904. Here, however, defendants have failed to produce any evidence that other shareholders in fact had obligations of even remotely similar size and timing which could be satisfied by the payment of

a liquidating dividend, or that the Gramlichs knew that this was indeed the case. *Cf. id.* (directors' approval of merger not based on self-interest in obtaining tax benefits where evidence showed that directors knew many shareholders would benefit from tax-free nature of transaction). Indeed, there is little reason to even presume that TRT shareholders were similarly saddled with sizable and imminent personal financial obligations, unlike the more generally applicable capital stock tax benefit in *Buffalo Forge.* Defendants' argument that TRT share dividends received by the Gramlichs would have been sufficient to pay the interest expense on the loan is also not dispositive. Even if defendants' argument is numerically accurate, the essence of plaintiff's claim of self-interest is based on the Gramlichs' desire to generate funds sufficient to liquidate the loan and thus avoid paying interest expense altogether. In short, we cannot presently conclude that the Gramlichs' loan obligation played no role in their decision to sell TRT assets and liquidate the trust.

Plaintiff also alleges that J. Harlan Stamper was motivated by self-in-

terest in his decision-making based on his membership in the law firm of Morris, Larson, King, Stamper & Bold, counsel to TRT. Plaintiff argues that Stamper's decision to oppose the BCG tender offer and to approve the sale and liquidation plan were tainted by the fact that his firm stood to preserve, at least temporarily, its relationship due to the former decision and receive substantial legal fees with respect to the latter. Defendants argue that these facts, as a matter of law, do not constitute self-interest. This Court has previously held, in related litigation, that the above facts were sufficient to demonstrate a "financial stake ... in the transaction" which prevented the other disinterested trustees' knowledge from being attributed to the trust in order to avoid a finding of deception. *See Bolton v. Gramlich*, 540 F.Supp. 822, 838–39 (S.D.N.Y.1982) (*quoting Maldonado v. Flynn*, 597 F.2d 789, 793 (2d Cir.1979)).[22] It is far from clear that this finding renders Stamper self-interested in the instant case *a fortiori*, given the differing purposes for which the determination of self-interest is being made. A director or trustee is not disloyal merely because he or she has an indirect financial interest in a partic-

ular transaction; disloyalty or lack of good faith is demonstrated by evidence that the fiduciary was improperly influenced by personal considerations or benefits not available to other shareholders generally. *See Crouse-Hinds Co. v. InterNorth, Inc.*, 634 F.2d 690, 702–03 (2d Cir.1980); pages 1018–1019 *supra*. Although the issue is a close one, we are presently unable to determine the extent to which this "financial stake" in fact influenced Stamper in his decision to oppose the BCG offer. Although the record reveals that Stamper appears to have given the transaction fairly thorough and objective consideration, the extent of financial benefit accruing to his firm as a result of the opposition to the BCG bid and the sale of assets to SFREI,[23] as well as his own recognition of potential self-interest, *see* Plaintiff's Ex. 14A, p. 86, create an issue of fact with respect to the possibility of self-interested conduct.[21]

Finally, plaintiff claims that the independence and financial disinterestedness of trustees Stamper (to the extent he was not otherwise self-interested), Murphy, and O'Flaherty was overcome by the Gramlichs' domination and control of TRT. In

order to sustain a claim of domination and control, a party must allege facts "manifesting 'a direction of corporate conduct in such a way as to comport with the wishes or interests of the corporation (or persons) doing the controlling.'" *Aronson v. Lewis*, 473 A.2d 805, 812 (Del.1984) (*quoting Kaplan v. Centex Corp.*, 284 A.2d 119, 123 (Del.Ch.1971)); *cf. McFarland v. Memorex Corp.*, [1979–1980 Transfer Binder] Fed. Sec.L.Rep. (CCH) ¶ 97,368, at 97,462 (N.D. Cal. May 14, 1980) ("[C]ontrol ... means the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract or otherwise.") (*quoting* 17 C.F.R. § 230.405(f) (1984)). While mere stock ownership, without more, does not constitute domination and control, *see Aronson, supra*, 473 A.2d at 815–17 (directors who owned 47% of stock and who personally selected other directors did not dominate and control), plaintiff has produced sufficient evidence to create an issue of fact in this regard. Plaintiff has produced evidence that other trustees were quite concerned with the goals and interests of

the Gramlichs, that they expressed reservations about the sale of TRT assets, that they were unaware of certain significant aspects of the sale to SFREI, and that these trustees believed that it was necessary to conduct (and did conduct, on February 5, 1981) a meeting in the Gramlichs' absence in order to consider the SFREI proposal. In addition, plaintiff notes that even at this meeting of "independent" trustees, the Gramlichs' attorney was present to represent their interests. In addition, plaintiff has produced evidence that this alleged dominating influence of the Gramlichs over trust management was simply a continuation of their prior influence over the trustees. *See* Plaintiff's Ex. 14A. This evidence is by no means overwhelming, particularly in light of the fairly thorough and objective consideration which the non-Gramlich trustees appear to have given the SFREI transaction. The line between mere influence over other trustees and domination of trust management is not an easy one to demarcate. But in view of the factors discussed above, the determination of whether this line was crossed must be made at trial. *See Aronson, supra,* 473

A.2d at 815–16; *cf. Treadway, supra,* 638 F.2d at 383–84 (appeal of final judgment) (no claim nor any evidence of domination and control by self-interested director).

Because the present record suggests potential self-interested conduct by a majority of the TRT trustees, *cf. Treadway, supra,* 638 F.2d at 383,[25] summary judgment cannot be granted based on the presumption of the business judgment rule. The Missouri state law standards of good faith and disinterestedness are fairly rigorous ones, and several bases for self-interest and disloyalty have been asserted. This Court's ability to resolve this issue would be enhanced by a factual inquiry into the extent to which the trustees' alleged financial interests and domination actually influenced their decisions to oppose the BCG tender offer, sell the trust assets to SFREI, and liquidate the trust.

Assuming that plaintiff succeeds in demonstrating self-interested conduct by the trustees, the trustees must then demonstrate that the challenged transactions were fair and reasonable to TRT and its shareholders. There appears to be consid-

erable variation among courts which have applied this general standard in the context of takeover battles, including a requirement that a compelling business purpose be demonstrated, *see Klaus v. Hi-Shear Corp.*, 528 F.2d 225, 233–34 (9th Cir.1975); a careful inquiry into the substantive fairness of the transaction, *see Mobil, supra,* [1981–1982 Transfer Binder] Fed.Sec.L. Rep. (CCH) at 92,274, 92,285; a search to determine the "independent legitimacy" of the transaction in addition to the alleged business purposes for opposing the tender offer, *see Norlin, supra,* at 265–267; and a search for a proper or rational business purpose for the transaction. *See Johnson v. Trueblood,* 629 F.2d 287, 292–93 (3d Cir. 1980), *cert. denied,* 450 U.S. 999, 101 S.Ct. 1704, 68 L.Ed.2d 200 (1981); *see also Treadway, supra,* 638 F.2d at 381. The instant case is also somewhat complicated in that the opposition to the tender offer consisted of the sale and liquidation of the target, rather than the mere securing of a higher bidder for the target's stock. While this fact by no means renders the transaction more suspect or inherently unfair, it requires this Court to consider a number of

interrelated and potentially inconsistent factors in determining the fairness and reasonableness of the transactions at issue. In so doing, we will consider both the substantive fairness of the transactions as well as the purposes for which they were consummated.[26]

Plaintiff's allegation of unfairness rests primarily on the purported "fire sale" prices at which the TRT assets were sold. Plaintiff has submitted evidence that the properties sold to SFREI had been reappraised, four days prior to the sale, at amounts far in excess of both the sales price and prior appraisals of the property;[27] that changes in real estate market conditions rendered the 1980 appraisals of TRT assets obsolete;[28] that an unexpired right of first refusal on the most valuable building significantly reduced the amount that TRT could obtain for its sale at the time of the BCG offer; and that the trustees could foresee significant increases in the value of TRT assets at the time the property was sold. Plaintiff also suggests alternative courses of action which, in its view, would have been far more reasonable

and profitable for TRT and its shareholders.[29]

Defendants offer an abundance of reasons in justification of the trustees' acts. Primary among them are: (1) the potential loss of TRT's favorable tax status as a REIT had the BCG tender offer been successful; (2) the potential loss of TRT's share listing on NASDAQ (and thus a decline in marketability and value); (3) the shareholders' loss of the benefit of reporting and disclosure provisions of the Securities and Exchange Act;[30] (4) the favorable comparison of the liquidating dividends paid to *all* TRT shareholders, totalling $33.50, with either the BCG tender offer of $33.50 for approximately 34% of the TRT shares, or any other offer for TRT shares or assets; (5) the relative ineffectiveness of trustee passivity, *i.e.*, merely recommending that shareholders not tender their shares to BCG;[31] and (6) a fervent objection to plaintiff's method of valuing TRT's assets as of February, 1981.[32]

We do not believe the issues raised by the parties can properly be resolved at this stage of the litigation. Of primary concern is the dispute surrounding

the value of TRT assets both at the time of sale and for the then-foreseeable future. While perhaps it is not necessary to determine the precise value of TRT assets as of February 6, 1981 in order to properly resolve the fairness and reasonableness issue, *cf. Mobil, supra,* [1981–1982 Transfer Binder] Fed.Sec.L.Rep. (CCH) at 92,274 (denial of preliminary injunction), plaintiff has produced evidence suggesting that the sale of TRT assets occurred at a price and time which rendered the transaction seriously deficient from an economic viewpoint. *Cf. Bolton v. Gramlich, supra,* 540 F.Supp. at 840 n. 25. Resolution of the factual disputes surrounding the value of TRT assets is of significant consequence to plaintiff's claim and cannot properly be decided at this time.[33]

Plaintiff also raises factual questions with respect to the significance of other factors surrounding the BCG tender offer. The effect of TRT's loss of REIT status is unclear, in light of the decreased earnings and anticipated losses and increased expenses of TRT both before and after the sale, *see, e.g.,* Plaintiff's Ex. 2, 291;

see also Plaintiff's Reply, at 30 (noting five-year renewal of leases for 40% of Lincoln Tower Building space at rates well below fair rental value), the trustees' own uncertainty regarding the significance of REIT status, *see* Plaintiff's Ex. 14A, and the fact that other tender offers were considered which involved the same potential for loss of REIT status, *see* Plaintiff's Ex. 486.[34] In addition, the fact that the potential consequences of a BCG tender offer were thoroughly considered by the trustees is not dispositive of our inquiry; if the presumption of good faith and disinterestedness is overcome, our task will be to evaluate not only the purposes for which the trustees acted but the fairness of the transactions themselves. *See Norlin, supra,* at 267 n. 13; *Mobil, supra.*[35]

We recognize the reluctance of courts to intrude into the decision-making processes of business fiduciaries faced with developments of major import which demand fairly immediate response. Nevertheless, several considerations weigh against resolution of the breach of fiduciary duty issue at this preliminary stage. The disparity in price

and fair market value asserted by plaintiff distinguishes this case from others in which directors' decisions in response to tender offers were found to be fair and reasonable. *Cf. Buffalo Forge, supra,* 555 F.Supp. at 905 (sale of treasury stock); *Mobil, supra,* [1981–1982 Transfer Binder] Fed.Sec.L.Rep. (CCH) at 92,274 (granting of stock and asset purchase options). The extraordinary nature of the instant transactions also supports a determination made only after the aforementioned factual issues are resolved. *Cf. Joseph E. Seagram & Sons, Inc. v. Abrams,* 510 F.Supp. 860 (S.D.N.Y.1981) (issuance of temporary restraining order enjoining directors from liquidating company in response to unsolicited tender offer). Finally, we recognize that the principal cases in which courts have upheld directors' responses to hostile takeover bids have been decided in circumstances where findings of fact were first made.[36] While defendants may ultimately succeed in demonstrating the propriety of the TRT trustees' conduct, we are presently unwilling to conclude that Missouri courts would refuse, as a matter of law, to hold the trustees liable under the circumstances of the instant case.

b. *Knowledge*

In order to sustain a claim of aiding and abetting, plaintiff must demonstrate evidence of SFREI's knowledge of wrongdoing by the TRT trustees. Actual knowledge of a breach of duty is required; mere suspicion or even recklessness as to the existence of a breach is insufficient. *See Marine Midland Bank, supra,* 482 F.Supp. at 1290 (breach of fiduciary duty); *Kransdorf, supra,* 582 F.Supp. at 337–38 (fraud and mismanagement); Restatement (Second) of Torts § 876, Comment on Clause (b); *cf. Harmsen v. Smith,* 693 F.2d 932, 943 (9th Cir.1982) (securities law), *cert. denied,* — U.S. ——, 104 S.Ct. 89, 78 L.Ed.2d 97 (1983); *Edwards & Hanly, supra,* 602 F.2d at 485 (same). The burden of demonstrating actual knowledge, although not insurmountable, is nevertheless a heavy one. Especially where the alleged aider and abettor owes no fiduciary duty to, or has no confidential relationship with, the injured party, *cf. Armstrong v. McAlpin,* 699 F.2d 79, 91 (2d Cir.1983); *Woodward v. Metro Bank of Dallas,* 522 F.2d 84, 97 (5th Cir.1975); *H.L. Federman & Co. v. Greenberg,* 405 F.Supp. 1332, 1336–

37 (S.D.N.Y.1975), liability cannot be imposed absent a showing that the defendants had actual knowledge of tortious conduct by the primary wrongdoer. In this connection, it is important to recognize that the nature of liability sought to be imposed with respect to this claim is not merely the return of the TRT assets sold to SFREI, *cf.* pages 1031–1033 *infra*, but affirmative monetary relief for SFREI's role in the alleged wrongdoing. Actual knowledge, not mere notice or unreasonable unawareness, is therefore essential. *See Metge v. Baehler*, 577 F.Supp. 810, 824 (S.D.Iowa 1984) (summary judgment) (inference that party had strong suspicion of other party's fraud not sufficient to support inference of actual knowledge); *Wright v. Schock*, 571 F.Supp. 642, 663 (N.D.Cal.1983) (allegation that bank "must have known" of broker's alleged securities fraud insufficient to defeat summary judgment motion on aider and abettor claim).[37]

Plaintiff must produce evidence of SFREI's knowledge not only of the objective unfairness and unreasonableness of the instant transaction, but also of facts

and circumstances demonstrating that the trustees acted in furtherance of their own self-interest. Even under the stringent standards of summary judgment, plaintiff has failed to produce evidence creating a genuine issue of fact on this issue. It may be conceded that SFREI may have known of the Gramlichs' interest in TMC and of their efforts, through negotiations with Unicorp and SFREI itself, to maintain it. It may be conceded, though the evidence is relatively sparse, that SFREI had similar knowledge with respect to the Gramlichs' loan obligation.[38] Whether or not SFREI knew of the Gramlichs' alleged self-interested conduct, however, the evidence fails to establish any genuine basis for finding that SFREI knew of Stamper's alleged self-interested conduct or of the Gramlichs' domination of the other trustees. Although SFREI apparently knew that Stamper's law firm performed legal services for TRT, they knew of neither his own ambiguous expression of potential conflict-of-interest, nor of his alleged interest in selling TRT assets rather than obtaining a tender offer for TRT shares. Indeed, the financial benefits received by Stamper's law firm incident to the sale of TRT assets were the

result of SFREI's own inability to engage in a tender offer for TRT shares.[39] We recognized earlier that Stamper's alleged self-interest presented a difficult question, and was predicated on inferences which, under somewhat similar circumstances, have been firmly rejected. *See* pages 1021–1022 *supra*. Even assuming such self-interested conduct could conceivably be shown, SFREI's actual knowledge of this is simply not supported by evidence in the record.

A lack of evidence similarly undermines plaintiff's claim that SFREI knew of the Gramlichs' domination and control. While SFREI knew that TMC managed TRT properties and that TMC was owned primarily by the Gramlichs, no showing has been made that SFREI knew of the Gramlichs' domination and control of the other trustees in their conducting of trust business. The record fails to indicate SFREI's awareness of any of the aforementioned factors which give rise to factual issues regarding domination and control. *See* pages 1022–1023 *supra*. Although the determination of whether domination and control by the Gramlichs in fact occurred will depend in

significant part on the trustees' own impressions of the manner in which trust business was conducted, there is no evidence indicating that SFREI had actual knowledge of the existence of such domination. As noted previously, whether SFREI should have realized this possibility or was perhaps unreasonable in failing to recognize it is relevant only to SFREI's potential restitutional duty to plaintiff, not to SFREI's potential liability as an aider and abettor. Thus, even if reasonable inferences could support a finding that SFREI actually knew of the Gramlichs' various self-interested motives for their conduct, similar inferences with respect to the non-Gramlich trustees are far too attenuated to create a genuine factual issue.

Absent knowledge of self-interested conduct by a majority of the TRT trustees, SFREI's actual knowledge of the alleged unfairness of the challenged transactions is insufficient to subject it to aider and abettor liability. In any event, the voluminous submissions of both parties fail to create a genuine issue regarding SFREI's alleged knowledge of the unfair-

ness and lack of business purpose surrounding the sale and liquidation transactions. SFREI may have believed (though they strongly dispute) that the trustees were exercising poor business judgment; such a possibility, however, is insufficient to establish knowledge of all the necessary elements of the breach of duty alleged in the instant case. Plaintiff's evidentiary submissions suggest that SFREI had a strong basis for believing that the 1980 appraisals were obsolete, knew that the transaction was extremely favorable for SFREI, knew that the purchase of properties with outstanding rights of first refusal was unusual and would have resulted in a discounted selling price, and was aware of the generally favorable trend in real estate values at the time (the benefit of which was being taken from TRT shareholders). Defendants have countered with evidence indicating that SFREI knew of the many legitimate reasons for opposing the BCG tender offer—risks which were expressly disclosed in BCG's Offer to Purchase, that it knew its offer to purchase TRT assets was higher, on a per share basis, than any other offer for TRT properties or shares, and that it believed the price paid for TRT

assets was reasonable in view of the other offers that had been made, the various risks associated with the acquisition of the property which may have impeded its market value (*i.e.*, "due on sale" provisions, necessary renovations, long-term leases at unfavorable rental rates), and the alleged instability of the Denver real estate market at the time. In addition, plaintiff does not allege that defendants had any knowledge of the February 2, 1981 revaluations of TRT assets which were computed at the TRT trustees' request. The above evidentiary submissions are by no means inconsistent or irreconcilable, but this very fact reveals the inadequacy of plaintiff's actual knowledge claim: even assuming plaintiff's assertions are true, defendants' uncontradicted assertions establish the basis for its belief in the reasonableness of the transaction from TRT's point of view. Whether one set of factors noted above should have prevailed over the other in the minds of SFREI trustees is relevant only to whether SFREI should have been aware of the possible unfairness of the transaction; it does not, however, establish the requisite knowledge for aider and abettor liability. *Cf.*

Restatement (Second) of Torts § 876, Comment on Clause (b) (aider and abettor liability imposed where person "knowingly gives substantial aid to another who, as he knows, intends to do a tortious act").[10]

In addition to the above analysis, several other considerations reveal both the potentially far-reaching consequences and general inappropriateness of imposing aider and abettor liability in these circumstances.[11] Primary among them is the indisputable fact that no duty, fiduciary or otherwise, existed between the parties in the instant case. Indeed, SFREI had a duty to its own shareholders to aggressively pursue economically favorable transactions, rather than shield or warn TRT shareholders of the consequences of their own trustees' decisions. *Cf. Grumman Allied Industries, Inc. v. Rohr Industries, Inc.*, 748 F.2d 729, 739 (2d Cir.1984) (seller of $55 million worth of assets has no duty to disclose material facts to buyer since parties had no fiduciary relationship). The absence of such a duty distinguishes this case from many in which aider and abettor liability has been alleged and supports the

imposition of the stringent actual knowledge requirement. *See Armstrong, supra,* 699 F.2d at 91; *see also Landy, supra,* 486 F.2d at 162–63 (citing Restatement definition); *Ingenito v. Bermec Corp.,* 441 F.Supp. 525, 533–34 (S.D.N.Y.1977). In essence, plaintiff seeks to impose affirmative liability on business managers who, at worst, may have failed to reasonably exercise their own business judgment in evaluating the benefits and risks of a particular commercial transaction to shareholders of the other contracting party, where absolutely no fiduciary duty or confidential relationship existed between these managers and the allegedly injured shareholders. The record simply does not raise a genuine issue as to the presence of the significantly higher degree of culpability which is necessary to impose aider and abettor liability in the instant case.

The nature of wrongdoing alleged in this case also supports a requirement that a party actually know that a breach of fiduciary duty is intended and consummated. Transactions which may appear reasonable at the time they are entered into may, upon more considered and deliberate

reflection, prove to be objectively unreasonable. However, to impose affirmative liability on a purchaser in a commercial transaction without concrete evidence of both its knowledge of the self-interest or bad faith of the seller and its unavoidable awareness of the transaction's substantive unfairness or lack of business purpose would disrupt commercial activity in a manner wholly inconsistent with the purposes of aider and abettor liability. *Cf. Woodward, supra,* 522 F.2d at 97 (aiding and abetting securities fraud) ("[T]he knowledge requirement implicates the type of document labelled a security. Where, as in this case, the conclusion that a security even exists is highly questionable, the assistance must be clearly and intentionally directed toward aiding the fraud. Any other rule would wreak havoc with all commercial relationships, a result we do not desire."); *IIT v. Cornfeld,* 619 F.2d 909, 922 (2d Cir.1980) (existence of knowledge element depends on theory of primary wrongdoing). The facts and permissible inferences may support a finding that SFREI should have been alert to the possibility of self-interest or unreasonably ignored this possibility; to interpret such

facts as a basis for inferring actual knowledge of improper motives and objective unreasonableness would impose a burden of second-guessing on parties such as SFREI which is wholly unwarranted in the context of commercial transactions. While an unreasonable disregard or constructive notice of facts constituting a breach of duty may support an equitable restitutional obligation in these circumstances, the policies underlying such a duty do not justify, at least in these circumstances, the imposition of a duty in tort giving rise to civil liability. *See Armenian Hotel Owners, Inc. v. Kulhanjian,* 96 So.2d 146 (Fla.1957).[12]

Finally, the transaction at issue involved no facially or overtly illicit benefit to SFREI which might enable this Court to infer actual knowledge of a breach of duty by the TRT trustees. *Cf. IIT v. Cornfeld, supra,* 619 F.2d at 921–22. The alleged disproportion between property value and purchase price, even if demonstrated at trial, was simply of a different character—the fruits of an arm's-length commercial transaction in which the alleged aider and abettor had an independent duty to obtain

the most favorable terms. In addition, this is not a case in which the disparity in price is so overwhelming and absence of legitimate business purpose so evident that knowledge of irregularity can reasonably be presumed. *Cf. Norlin, supra*, at 264-268 (incumbent directors' creation of director-controlled ESOP and issuance of corporate stock to ESOP, effectively giving directors voting control over nearly a majority of corporation's shares, likely constitutes breach of fiduciary duty since no real consideration received by corporation for newly issued shares and ESOP created solely to preserve directors' control).

Finally, the circumstances in which the challenged conduct occurred further illustrates the inappropriateness of imposing aider and abettor liability in this case. Courts have been loath to impose liability on business managers for acts taken in response to hostile takeover attempts. The reluctance to impose similar liability on non-fiduciary third parties in such circumstances is at least as compelling. Defendants have produced plentiful evidence of SFREI's knowledge of both the benefits to

TRT of the challenged transactions and the negative consequences of a successful BCG tender offer. Plaintiff's factual submissions, even favorably viewed, fail to support the conclusion that SFREI not only acted unreasonably in its evaluation of the reasonableness of these transactions but also actually knew that the precise opposite was true.

In sum, given the absence of genuine factual issues, and in view of the aforementioned considerations, the imposition of the potentially drastic and far-reaching liability sought in the instant case is totally unwarranted. Accordingly, defendants' motion for summary judgment with respect to plaintiff's aider and abettor liability claim is granted.[13]

2. *Duty of Restitution*

Plaintiff's attempt to impose a duty of restitution on SFREI is predicated on two grounds.

First, plaintiff seeks to hold SFREI accountable pursuant to the equitable rule that a purchaser of property takes it subject to a duty of restitution if the purchaser has *notice* that the transfer

by the seller constitutes a breach of fiduciary duty. *See, e.g., Wallace v. Malooly*, 4 Ill.2d 86, 122 N.E.2d 275, 282 (1954); *B.J. McAdams, Inc. v. Boggs*, 439 F.Supp. 738, 752 (E.D.Pa.1977); Restatement of Restitution § 201 (1937). A party has notice of a breach of duty if it knows or should know that such a breach has been committed. *See* Restatement of Restitution § 174; *cf.* Restatement (Second) of Trusts § 297(a) (1959).[11] As we have already noted, issues of fact remain with respect to the breach of fiduciary claim. *See* pages 1018–1027 *supra*. It would also be premature to decide whether SFREI should have known of the trustees' alleged self-interest and the substantive unfairness of the transaction to TRT. Both parties have produced evidence which, if uncontroverted, indicates either that SFREI had reason to suspect such a breach of duty or that SFREI had a reasonable belief that the trustees were entirely justified in their actions. This determination can best be made after the factual issues surrounding the alleged breach of fiduciary duty are resolved at trial.

Second, plaintiff argues that the TRT trustees' purported authorization of both

the sale and liquidation was ineffective and in violation of the TRT Declaration of Trust. Because the trustees were allegedly "interested" in the sale and liquidation, plaintiff argues that they were unable to exercise the voting power which was necessary to effectuate these transactions. SFREI's notice of such trust violations, it is argued, renders it liable as a constructive trustee of the transferred property.

The TRT Declaration of Trust states that a decision to liquidate the trust must be approved by either a majority vote of the shareholders "or by the unanimous action of all of the Trustees in office." TRT Declaration of Trust, Art. VI, § 1. The Declaration of Trust also provides that "all ... transactions in which any [Trustee, officer or manager has] any direct or indirect interest shall be approved by a majority of the Trustees, including a majority of the Trustees who are not Affiliated with the Manager." *Id.* Art. III, § 14.

Resolution of plaintiff's claim requires a distinction to be drawn between the potentially self-interested motivations of trustees which subject them to liability

for breach of fiduciary duty and the direct interest in a transaction which disqualifies them from voting. Regardless of whether trustees were improperly motivated, for financial reasons or otherwise, to approve the sale and liquidation and thus are to be deprived of the good faith presumption of the business judgment rule, this potential for self-interest is insufficient to deprive the trustees of their contractual or legal power to vote. Plaintiff's authorities establish only the equitable rule disqualifying directors or trustees from voting in matters in which their interests are directly adverse to those of the corporation or trust, where the voting fiduciary is a party to the very transaction requiring fiduciary approval. *See, e.g., Weiss Medical Complex, Ltd. v. Kim*, 87 Ill.App.3d 111, 42 Ill.Dec. 250, 254, 408 N.E.2d 959, 963 (1980) (director disqualified from voting to remove restrictive covenant from employment contracts, including his own); *Gieselmann, supra*, 443 S.W.2d at 134–36 (director disqualified from voting to issue stock to himself and to cause corporation to pay him for legal services which he rendered to it); *Von Schrader v. Cornet*, 3

S.W.2d 706 (Mo.1927) (beneficiary unable to authorize his purchase of land from trustees); *Hill v. Rich Hill Coal Min. Co.*, 119 Mo. 9, 24 S.W. 223 (1893) (sale of land by director to corporation); *Christy v. Laclede-Christy Clay Products Co.*, 253 S.W. 106, 107 (Mo.Ct.App.1923) (director disqualified from voting against abolishing his status as corporate officer); 16A Fletcher Cyclopedia of the Law of Private Corporations § 8257, at 619 (R. Eickhoff rev. ed. 1979) ("generally speaking, a trustee's personal adverse interest disables him to vote in matters affected thereby") (citing case involving business trustee's attempt to approve trust's payment of claim to himself). A comparable transaction in the instant case—for example, a trustee voting to increase his compensation for trustee services rendered—would be barred under this principle. *See* Ex.B, SFREI's Requests for Admissions (minutes of 1/19/81 TRT Trustees meeting), at 14 (noting abstention of trustees Murphy and O'Flaherty from vote to increase their compensation). Unless otherwise specifically provided, however, the trustees' indirect receipt of financial benefits pursuant to preexisting, previously authorized contractual relationships is

not the type of interest which disqualifies them from voting on trust matters.[15] In any event, the Declaration of Trust provides its own specific limitation on trustee approval of sales transactions in which such indirect interests exist: these transactions require majority approval, including a majority of non-Gramlich trustees. *See* TRT Declaration of Trust, Art. III, § 14.[16] Since the Gramlichs did have an "indirect" interest in the sale to SFREI, this transaction required the approval of three of five trustees, including two affirmative votes from among trustees Stamper, Murphy, and O'Flaherty.[17] All trustees voted to sell the TRT assets to SFREI. Whether the affirmative votes of the non-Gramlich trustees were legally effective and valid, however, will depend on whether plaintiff can establish its claim of domination and control by the Gramlichs. The existence *vel non* of domination and control, and of SFREI's notice of same,[18] involve factual determinations which prevent this Court from presently resolving the merits of plaintiff's restitutional claim.

Accordingly, both plaintiff's and defendants' motions for summary judgment with

respect to SFREI's restitutional liability are denied.

CONCLUSION

For the reasons discussed above, defendants' motion for summary judgment is granted in part and denied in part, and plaintiff's motion for partial summary judgment is denied.

SO ORDERED.

1. Jurisdiction is based on diversity of citizenship under 28 U.S.C. § 1332 (1982). Plaintiff is a New York business trust; defendant SFREI, Inc. is a Delaware corporation and the individual trustees are citizens of California, Canada, Colorado, Massachusetts and Pennsylvania.

2. TRT was a qualified real estate investment trust within the relevant provisions of the Internal Revenue Code, 26 U.S.C. §§ 856–860 (1982). Under these provisions, a qualified REIT is taxed only on its undistributed income and capital gains; distributed income is taxed only at the shareholder level.

3. The events giving rise to this lawsuit have been the basis of prior litigation before this Court. *See Terrydale Liquidating Trust v. Gramlich*, 549 F.Supp. 529 (S.D.N.Y.1982) (action by TLT against TRT trustees, SFREI and others for violation of federal securities laws); *Bolton v. Gramlich*, 540 F.Supp. 822 (S.D.N.Y.1982) (ac-

tion by defeated tender offeror against TRT trustees, SFREI and others for violation of federal securities laws). Familiarity with these decisions is assumed.

4. Determinations of percentage share ownership are complicated by the existence of warrants to purchase 221,800 TRT shares; warrants to purchase 115,937 TRT shares had been exercised as of January 8, 1981. *See* Defendants' Ex.A, SFREI's Requests for Admissions (BCG Offer to Purchase), at 2.

The following schedule provides a summary of BCG's share ownership, both including and excluding the outstanding warrants which had been exercised prior to the BCG tender offer:

	Before tender offer	Tender offer, if fully subscribed
shares	123,245 (26.7%) *	160,000 (34.7%) *
warrants	4,500	–
total	127,745 (22.1%) **	160,000 (27.8%) **

	After tender offer, if fully subscribed
shares	283,245 (61.4%) *
warrants	4,500
total	287,725 (49.9%) **

* based on 461,064 outstanding shares as of 12/16/80

** based on 577,001 shares (461,064 outstanding shares, and exercise of warrants to purchase 115,937 TRT shares)

5. The trustees of TRT at the time of the challenged events were J. Russell Gramlich (an approximately 19.6% shareholder); John G. Gramlich, his son (who, together with Michael J. Gramlich, his brother, and James A. Kostoryz, his brother-in-law, owned directly and through other organizations approximately 8.8% of TRT's shares); J. Harlan Stamper, whose law firm was counsel to TRT; Thomas J. Murphy, and John D. O'Flaherty. The Gramlich family also owned approximately 68% of Terrydale Management Corporation (hereinafter "TMC"), a corporation which received management and brokerage fees for services performed in connection with the managing of TRT properties.

6. BCG considered offering to issue bonds with a fair market value of $33.50 in exchange for the remainder of the outstanding TRT shares. *See* Defendants' Ex. B, SFREI's Requests for Admissions (minutes of 1/19/81 TRT Trustees meeting), at 3–4. This proposal was apparently subsequently modified to include terms less favorable to TRT. *See* Defendants' Ex. C, SFREI's Requests for Admissions (minutes of 2/2/81 TRT Trustees meeting), at 5–6.

7. Plaintiff's Ex. 486 indicates that the Unicorp offer involved the possible acquisition of 300,000 TRT shares.

8. Mann was a member of SFREI's Board of Trustees.

9. TLT, a liquidating trust, was created in accordance with § 337 of the Internal Revenue Code as successor to the remaining undistributed assets of TRT.

10. The plaintiff in this action is thus, in effect, the "defeated" tender offeror.

11. Plaintiff does *not* seek the return of (1) the Lincoln Tower Building, which was subsequently acquired by Subdale Corporation pursuant to the exercise of a right of first refusal which its parent, the Lincoln Tower Building Corporation, possessed with respect to TRT's sale of the building, or (2) liquidating distributions received by non-trustee shareholders of TRT.

12. Missouri aider and abettor cases involve either criminal conduct, *see, e.g., Helming v. Adams*, 509 S.W.2d 159, 162 (Mo.Ct.App.1974), or physical intentional torts, *see, e.g., Knight v. Western Auto Supply Co.*, 239 Mo.App. 643, 193 S.W.2d 771 (1946). Both of these cases, however, articulate a standard for determining aider and abettor liability which has been adopted in the civil context, *see, e.g., IIT v. Cornfeld*, 619 F.2d 909, 922 (2d Cir.1980), and has been harmonized with the Restatement standard. *See Landy v. Federal Deposit Insurance Co.*, 486 F.2d 139, 163–64 (3d Cir.1973), *cert. denied*, 416 U.S. 960, 94 S.Ct. 1979, 40 L.Ed.2d 312 (1974); *Mendelsohn v. Capital Underwriters, Inc.*, 490 F.Supp. 1069 (N.D.Cal.1979).

13. Although we conclude for reasons stated herein that summary judgment should be granted on plaintiff's aider and abettor claim because of the absence of actual knowledge by the alleged aider and abettor, we discuss the breach of fiduciary duty element in detail because of its relevance to the restitutional claim as to which summary judgment is denied.

14. Defendants appear to assume that this mode of analysis is appropriate. Plaintiff's briefs are devoted largely to a refutation of defendants' analysis of the business judgment rule as applied to the facts of this case, rather than a challenge to the applicability of this mode of analysis in general. Plaintiff does, however, note at one point that the trustees are subject to the duties imposed on trustees generally, *see* Plaintiff's Reply Brief, at 67–68, thus at least suggesting that a stricter standard should apply.

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15. Missouri courts have applied a similar standard to transactions involving self-dealing between the fiduciary and the corporation. *See, e.g., Ramacciotti v. Joe Simpkins, Inc.*, 427 S.W.2d 425 (Mo.1968). Yet, if plaintiff establishes that the trustees' decision to sell and liquidate trust assets was founded on considerations of personal profit or self-interest, this would also appear to be sufficient grounds for imposing a burden of justification on the trustees. Indeed, a similar standard has been applied in the context of corporate takeover battles. *See, e.g., Norlin Corp. v. Rooney, Pace Inc.*, 744 F.2d 255, 264–265 (2d Cir.1984); *Treadway Companies, Inc. v. Care Corp.*, 638 F.2d 357, 382 (2d

Cir.1980); *Mobil Corp. v. Marathon Oil Co.*, [1981–1982 Transfer Binder] Fed.Sec.L.Rep. (CCH) ¶ 98,375, at 92,284 (S.D.Ohio Dec. 7, 1981), *rev'd on other grounds*, 669 F.2d 366 (6th Cir.1981). We thus consider it appropriate to apply this standard to the instant case.

16. A somewhat more deferential standard has been applied where retention of control is the alleged basis for self-interest. *See, e.g., Panter v. Marshall Field & Co.*, 646 F.2d 271, 294 (7th Cir.) (impermissible motives must predominate), *cert. denied*, 454 U.S. 1092, 102 S.Ct. 658, 70 L.Ed.2d 631 (1981); *Johnson v. Trueblood*, 629 F.2d 287, 293 (3d Cir.1980) (sole or primary purpose must be to retain control), *cert. denied*, 450 U.S. 999, 101 S.Ct. 1704, 68 L.Ed.2d 200 (1981). This standard is considered appropriate where retention of control is an alleged motive since such a motive is virtually inherent in acts undertaken in opposition to a hostile bidder; thus, courts require more than an allegation of control as "a" motive for the director's acts, lest the business judgment rule be rendered meaningless in such circumstances. This rule, however, has been subject to less deferential application, *see Mobil, supra*, [1981–1982 Transfer Binder] Fed.Sec.L.Rep. (CCH) at 92,284–85; *see also Norlin, supra*, at 265 (business judgment rule inapplicable where directors "shown to have a self-interest in the transaction at issue"), and has even been criticized for its leniency. *See Panter, supra*, 646 F.2d at 304 (Cudahy, J., dissenting); *Johnson, supra*, 629 F.2d at 301 (Rosenn, J., dissenting). In any event, because

Missouri courts require a fairly convincing showing of fiduciary good faith, and since the alleged self-interest in this case is primarily the specific financial benefits arising from the sale and liquidation transactions, evidence that this interest was a significant motivating factor underlying the trustees' conduct should be sufficient. *Cf. Klaus v. Hi-Shear Corp.*, 528 F.2d 225, 233–34 (9th Cir.1975); *Mobil, supra*, [1981–1982 Transfer Binder] Fed.Sec.L.Rep. (CCH) at 92,285 n. 55.

17. As of November 1980, John Gramlich owned 145 shares of TMC (30.5%), Michael Gramlich owned 145 shares (30.5%), and James Kostoryz (John Gramlich's brother-in-law) owned 35 shares (7.4%). John Gramlich was president of TMC and J. Russell Gramlich, his father, was Chairman of the Board. *See* Plaintiff's Brief in Opposition to Defendants' Motion for Summary Judgment (hereinafter "Plaintiff's Brief"), at 6.

18. Additional circumstantial evidence of the Gramlichs' potential self-interest can be found in the decision of other trustees to hold a special meeting on February 5, 1981, one day before the sale to SFREI, "in the absence of J. Russell Gramlich and John J. Gramlich because the independent Trustees did not have a substantial interest in the Trust or Terrydale Management Corporation and therefore could be more objective with regard to the possible sale of assets and liquidation of the Trust, which were being considered by the Trustees." *See* Ex. C, SFREI's Requests for Admissions (minutes of 2/5/81 TRT Trustees meeting), at 15.

19. We thus reject defendants' contention that plaintiff essentially asks this Court to *presume* self-interest based on the existence of the TMC contract, a presumption which has been rejected with respect to a director's retention-of-control motive. *See Crouse-Hinds Co. v. InterNorth, Inc.*, 634 F.2d 690, 702–03 (2d Cir.1980). In *Crouse-Hinds*, the court rejected a claim of self-interest since the target directors had negotiated a merger with a white knight (and thus preserved their positions) prior to the announcement of the hostile tender offer. *Id.* at 703. The instant case is factually distinguishable.

In addition to submitting evidence in opposition to plaintiff's claim, defendants argue that the TRT shareholders' approval of the TMC management agreement precludes a finding of self-interest. Defendants refer to the TRT Proxy Statement, dated January 8, 1982, which discloses the amounts received by TMC during fiscal year 1981 in connection with its services as trust manager. However, this proxy statement does not establish the shareholders' approval of either the TMC contract or the sale to SFREI and simultaneous adoption of a liquidation plan; the proxy statement relates only to the creation of TLT and the selection of TLT trustees. In any event, plaintiff's claims of unfairness and self-interest, if established at trial, would appear to eliminate the effectiveness of shareholder ratification in the instant case. *See Saigh v. Busch*, 396 S.W.2d 9, 22 (Mo.Ct.App. 1965), *cert. denied*, 384 U.S. 942, 86 S.Ct. 1465, 16 L.Ed.2d 541 (1966).

20. We thus reject defendants' argument that the trustees, in voting to sell and liquidate the trust and thus eventually terminate the TMC/TRT relationship, cannot be found to have acted out of self-interest. As noted above, the trustees still could have reasonably foreseen that their decision would undermine, as it in fact did, the success of the BCG tender offer and thus insure the continuation of the TRT/TMC relationship for a considerable period of time; an unopposed offer would likely have led to a significantly more rapid termination of this relationship. In addition, defendants give insufficient weight to the fact that the sale itself generated substantial fees for TMC. We thus reject defendants' characterization of these financial advantages as merely temporary benefits. *Cf. Treadway, supra,* 638 F.2d at 387–88 (on petition for rehearing) (directors' pre-merger sale of stock to white knight not made for purpose of retaining control even though directors remained in office pending consummation of merger).

21. John Gramlich, together with his brother and brother-in-law, borrowed this amount in November of 1980 in order to pay for the acquisition of 36,737 TRT shares. These shares, along with an additional 25,000 TRT shares owned by J. Russell Gramlich, were held by the bank as security for the loan. *See* Plaintiff's Ex. 3.

22. In *Bolton,* this Court distinguished *Maldonado v. Flynn,* 597 F.2d 789 (2d Cir.1979), in which

the Second Circuit held that a director appointed to an independent investigation committee was not "interested" simply because his law firm was counsel to the committee, a circumstance which supposedly may have "motivated him to curry favor" with the interested parties. On remand, the district court held that the fact that the law firm was to be paid for its work did not support an inference that the lawyer was "somehow predisposed to a particular determination of the matter before the Committee." *Maldonado v. Flynn*, 485 F.Supp. 274, 283 (S.D. N.Y.1980) (Weinfeld, J.) (implication dismissed as "a non sequitur and hardly worthy of comment"), *rev'd on other grounds*, 671 F.2d 729 (2d Cir.1982). Unlike *Maldonado*, however, where the firm apparently was to receive legal fees regardless of the committee's decision as to whether or not to discontinue a derivative action, Stamper stood to benefit only if the trustees voted to oppose the tender offer and, more specifically, if the trust assets were sold. *But cf. Panter, supra*, 646 F.2d at 294 (no inference of self-interest drawn where target company director's investment banking firm performed work for company).

23. Stamper's law firm was paid $215,188 during the year ended September 30, 1981 for general legal services performed for TRT and for services relating to the purchase and sale of TRT trust properties. It is unclear what portion of this amount was earned subsequent to the sale to SFREI; nor is it clear whether, and to what extent, Stamper's firm earned fees subsequent to the above date.

24. As noted previously with respect to the Gramlichs, this Court cannot conclude at this stage that Stamper's knowledge that his decision would eventually lead to the termination of the TRT/law firm relationship precludes a finding of self-interested conduct. *See* fn. 20 *supra.*

25. Plaintiff raises an additional basis for finding that the trustees acted in their own self-interest. In our view, it cannot withstand careful scrutiny. According to plaintiff, the Gramlichs alleged desire to oppose the BCG tender offer and thus avoid being "locked in as a minority" was apparently based on its concern that the marketability of their stock would be diminished as a consequence of possible delisting of TRT shares from the National Association of Securities Dealers Automated Quotation (NASDAQ) System, and on the possible loss of TRT's REIT status—the likely consequences of a successful BCG tender offer. These consequences, however, would have befallen *all* TRT shareholders who chose not to tender their shares; thus, the trustee and non-trustee shareholders' interests were consistent and legitimate in this respect. In addition, there is no evidence to indicate that additional restrictions on the sale of the Gramlichs' shares, *see* Plaintiff's Brief, at 12 (discussing restrictions imposed by SEC Rule 144 on sale of TRT shares by "affiliates" of TRT or of "restricted securities"), actually motivated the Gramlichs to approve the sale of TRT assets; such restrictions, assuming they in fact applied, presumably existed prior to the BCG offer and may well have continued to apply even after the sale to SFREI. Thus, to the extent that the

above consequences are said to constitute an *independent* basis for finding self-interest, this argument is rejected.

26. Such an analysis is consistent with the rigorous standard of good faith and fair dealing imposed on directors under Missouri law, *see* page 1018 *supra;* there is also some authority suggesting that a valid business purpose will not shield directors from liability where the terms and other actions of the directors bespeak unfairness. *See Johnson v. Duensing, supra,* 351 S.W.2d at 32 (directors' sale of treasury stock undertaken to raise working capital held a breach of fiduciary duty where sale enabled the sellers and buyers to acquire majority ownership, was made at price below fair market value, and was made without effort to obtain highest possible price for stock). In addition, the rational business purpose standard has been the subject of some dispute, namely, that such a standard effectively reapplies the deference of the business judgment rule even where the rule has presumably been rendered inapplicable and the burden of demonstrating fairness shifted to the directors. *See, e.g.,* Note, Protecting Shareholders Against Partial and Two-Tiered Takeovers: The "Poison Pill" Preferred, 97 Harv.L. Rev. 1964, 1969–70 (1984); Note, The Misapplication of the Business Judgment Rule in Contests for Corporate Control, 76 Nw.U.L.Rev. 980 (1982); *see also* Wirth Introduces Bills to Limit Tender Offer Abuses, [Current] Sec.Reg. & L.Rep. (BNA) No. 21, at 913 (May 25, 1984)

(proposing legislation requiring target management to demonstrate that anti-takeover conduct was "prudent for the issuer and fair to shareholders"); *cf. Norlin, supra,* at 265–267. In light of the above factors, the fact that TRT is a business trust rather than a corporation (a distinction of uncertain import under Missouri law in these circumstances), and the procedural posture of the instant case, we are reluctant to accord undue deference in reviewing the propriety of the challenged conduct.

27. Plaintiff provides the following information about the value of the properties involved (in thousands):

	Selling Price	Fair Market Value
Lincoln Tower Bldg.	$14,134	$26,720
Petroleum Building	6,713	13,350
Century Bank Building	7,605	*
Travelers Building	2,845	4,860
Totals	$31,297	$52,535

	Terrydale Equity at Selling Price	Terrydale Equity at Fair Market Value
Lincoln Tower Bldg.	$ 8,138	$20,720
Petroleum Building	4,354	10,990
Century Bank Building	2,186	**
Travelers Building	2,420	4,435
Totals	$17,098	$38,331

* in excess of $7,605.

** in excess of $2,186.

Complaint at ¶ 12.

Plaintiff contends that the subsequent sale of the same equity interest in the Lincoln Tower Building for $18,400,000, over 100% more than TRT received approximately one and a half years earlier (when real estate values were allegedly higher), illustrates the sacrifice that TRT incurred in selling the trust assets to SFREI.

28. These appraisals were as follows:

	Appraiser	Date
Lincoln Tower Building	Blaine B. Chase & Co.	6/1/80
Petroleum Building	Van Court & Co.	10/13/80
Century Bank Building	Gunther & Associates	1/1/81
Travelers Building	Van Court & Co.	5/19/80

	Value (in thousands)
Lincoln Tower Building	14,134*
Petroleum Building	6,713
Century Bank Building	7,605
Travelers Building	2,846
Total	$31,298

* includes $3,854,000 wraparound mortgage due TRT.

29. Implicit in plaintiff's argument is the claim that the success of the BCG tender offer and continuation of TRT as an operating business trust would have been far more favorable than the sale and liquidation of TRT.

30. These three risks were disclosed in BCG's Offer to Purchase. *See* Defendants' Ex.A, SFREI's Requests for Admissions, at 3, 5.

31. Defendants also argue that the trustees could not be certain that BCG management, had it gained control of TRT, would have acted in such a way as to enable TRT shareholders to enjoy the benefits of any increase in real estate values. This implicit questioning of BCG's intent is speculative, disputed by plaintiff, and is in no way dispositive of the fairness and reasonableness issue. *See Norlin, supra,* at 267.

32. Defendants offer evidence of (1) the use of incorrect capitalization and rental rates and the drawing of improper comparisons of dissimilar buildings in Blaine Chase's preliminary revaluation of trust property; (2) testimony of Blaine Chase downplaying the significance of his calculations; (3) plaintiff's misplaced reliance on appraisals conducted almost one and two years after the sale to SFREI, and (4) the relative instability of the Denver real estate market at the time of sale.

33. Defendants strongly dispute plaintiff's suggestion that the trustees could have sold the TRT assets "in an orderly fashion ... not operating under the time constraints" of the BCG tender offer. Plaintiff's Brief, at 69. Although defendants may well be correct, this does not remove all factual dispute as to whether the trustees' decision to sell the assets in the manner and for the amount they did was fair and

reasonable as a matter of law. In this regard, plaintiff has produced evidence suggesting that the trustees' inability to obtain full value for the property may have been attributable to the significant risks associated with the purchase of at least two of the Denver buildings, namely, outstanding rights of first refusal which could not be satisfied prior to the consummation of the sales transaction, as well as the inability to find a buyer with the necessary cash at that time.

Defendants also argue that the trustees' power "[t]o determine conclusively the value of all or any part of the Trust property" and "to revalue" such property, *see* TRT Declaration of Trust, Art. III, § 2(r), effectively bars plaintiff's claim. Notwithstanding this legal power, however, the trustees cannot escape the power of an equity court to determine whether their sale of trust property was so unfair and for such improper motives (or tainted by sufficient self-interest) that it constituted a breach of fiduciary duty.

34. It is unclear from the record before us what the financial consequences would have been had the TRT shares been relegated to simple over-the-counter, as opposed to NASDAQ-reported, status. *See generally* Defendants' Ex.A, SFREI's Requests for Admissions (BCG Offer to Purchase), at 5.

35. Defendants argue that the trustees' reliance on the advice of counsel bars plaintiff's claim. The TRT Declaration of Trust specifically provides, however, that the opinion of counsel

"shall be full and complete authorization and personal protection in respect of any action taken or suffered by [the trustees] *in good faith* and in accordance with such opinion." TRT Declaration of Trust, Art. III, § 15 (emphasis added). Plaintiff's claim of self-interested conduct is clearly inconsistent with the protection afforded by this provision. In addition, the trustees relied on the advice of Stamper, who is allegedly a self-interested trustee, and Jerry Shulman, whose advice did not address the consequences of self-interested conduct by the trustees. *See* Shulman Deposition, at 115 (advising trustees that it was within their discretion to "sell and liquidate at what they considered to be fair market value."). We also reject defendants' argument that the TRT Declaration of Trust, Art. III, § 17, which provides that "any act of the Trustees purporting to be done in their capacity as such ... shall, as to other Persons dealing with such Trustees ... be conclusively deemed to be within the purposes of the Trust and within the powers of the Trustees," insulates SFREI from the power of an equity court to hold it accountable as a constructive trustee if SFREI is found to have had notice of the trustees' breach of duty. *See* pages 1031–1033 *infra*.

36. *See Buffalo Forge, supra* (appeal of judgment); *Panter, supra* (appeal of directed verdict); *Treadway, supra* (appeal of judgment); *Crouse-Hinds, supra* (appeal of granting of preliminary injunction); *Johnson v. Trueblood, supra* (appeal of judgment); *Mobil, supra* (denial of preliminary injunction).

37. Plaintiff contends that, as a matter of common law, a showing of recklessness should be sufficient to establish the element of knowledge. *See* Plaintiff's Brief, at 86 (citing *Rolf v. Blyth, Eastman Dillon & Co., Inc.*, 570 F.2d 38, 45 (2d Cir.) (aiding and abetting securities fraud) ("at common law, reckless conduct is viewed as a form of knowing conduct") (citing W. Prosser, Handbook of the Law of Torts § 107 (4th ed. 1971), *cert. denied*, 439 U.S. 1039, 99 S.Ct. 642, 58 L.Ed.2d 698 (1978)). Prosser's discussion, however, relates to the tort of misrepresentation, not to the imposition of secondary aider and abettor liability for one's role as a purchaser in an allegedly tortious sales transaction. In addition, the use of a recklessness standard in securities cases is limited to those situations in which the alleged aider and abettor owes a fiduciary duty to the plaintiff. *See Armstrong v. McAlpin*, 699 F.2d 79, 91 (2d Cir.1983); *Rolf, supra*, 570 F.2d at 44. The more highly regulated nature of securities transactions and the more clear-cut nature of securities violations in aider and abettor cases also support the imposition of a lower standard of knowledge than is appropriate here; the concern in these cases is typically with the relative degree of involvement of peripheral parties (*i.e.*, brokers, banks, accountants) to the fraud, not the ambiguous nature of the fraud itself. Finally, plaintiff cites no cases, nor can we find any, that have imposed or even considered a claim of aider and abettor liability on a showing of less than actual knowledge of wrongdoing in circumstances where the considerations noted in text are present.

38. The evidence suggests only that SFREI knew of the Gramlichs' loan obligation; there is no evidence indicating that SFREI knew of the Gramlichs' inability to satisfy this obligation by using their own personal assets or the collateral held by the bank. Nor is there evidence indicating that SFREI was aware of the bank's expression of concern with respect to the bank's ability to sell, if necessary, the TRT shares held as collateral.

39. Defendants have produced uncontradicted evidence that the structuring of the TRT/SFREI transaction as a sale, rather than a tender offer, was due to limitations in SFREI's own Declaration of Trust. Thus, even if Stamper may have nevertheless been motivated to *sell* the TRT assets, rather than solicit a tender offer superior to the BCG offer, in order to earn legal fees on the sale, *see* pages 1021–1022 *supra*, the record fails to indicate that SFREI actually knew that Stamper's motive for structuring the transaction as a sale of assets was a financially self-interested one. That SFREI should have realized this possibility is also contradicted by the fact that TRT's prior negotiations with Unicorp, SFREI's part-owner, contemplated a tender offer rather than an asset acquisition. *See* Plaintiff's Ex. 486. In any event, whether SFREI should have known of the trustees' alleged self-interested motives with respect to the challenged transactions is a question of fact which need not be resolved in order to dispose of plaintiff's aider and abettor claim.

40. Nor is it relevant that SFREI believed that it may have been acquiring TRT assets at an excellent price. What is relevant is whether TRT's sale of the assets, in the face of an unsolicited tender offer bid with potentially troubling economic consequences for TRT shareholders, constituted a breach of fiduciary duty by TRT trustees. Plaintiff's argument that SFREI's receipt of trust assets on favorable terms constitutes evidence of SFREI's knowledge of the trustees' alleged breach of fiduciary duty is simply a *non sequitur.*

41. A number of these considerations could also be just as easily ascribed to the "substantial assistance" element of aider and abettor liability. *See IIT v. Cornfeld, supra,* 619 F.2d at 922. In light of our above conclusion, we need not analyze in detail this element of aider and abettor liability. We do note, however, that this Court has not yet resolved this issue, *cf. Terrydale Liquidating Trust v. Gramlich, supra,* 549 F.Supp. at 531 (participation in sale did not substantially assist dissemination of allegedly misleading press release), and that the securities law cases cited by defendants do not answer the question of whether a purchaser's participation in an allegedly tortious sales transaction constitutes substantial assistance. And while we recognize that the knowledge and substantial assistance elements are related, *see IIT v. Cornfeld, supra,* 619 F.2d at 922, it appears that the difficulty in the instant case lies primarily in SFREI's lack of actual knowledge of wrongdoing, rather than in the fairly objectively determinable degree of its participation. *See general-*

ly Restatement (Second) of Torts § 876, Comment on Clause (b) (1982) (discussing factors for evaluating degree of assistance).

42. In *Kulhanjian,* a minority stockholder sued for an accounting and damages based on the directors' alleged fraudulent assignment of the corporation's leasehold interest in hotel property, its principal asset. The court held that the assignee's participation was a sufficient basis for holding him accountable as a constructive trustee; the court explicitly refused, however, to hold him liable for damages.

43. Courts have not hesitated to grant summary judgment where no genuine factual issues exist as to the elements of aider and abettor liability. *See, e.g., Cleary v. Perfectune, Inc.,* 700 F.2d 774 (1st Cir.1983); *Metge v. Baehler,* 577 F.Supp. 810, 820–25 (S.D.Iowa 1984); *Wright v. Schock,* 571 F.Supp. 642, 663 (N.D.Cal.1983); *Marine Midland Bank, supra,* 482 F.Supp. at 1290.

44. The Restatement (Second) of Trusts provides a useful multifactor test for determining whether a party should have known of another's breach of trust. *See* Restatement (Second) of Trusts § 297, Comment a (1959):

> Among the circumstances which are or may be of importance are the following: (1) whether he knows that the person with whom he is dealing is in fact a trustee; (2) the extent to which he has reason to believe that the person with whom he is dealing is or may be a trustee . . .; (3) the character of the property dealt with, whether it is land or a chattel or a chose in action, negotiable or non-negotiable;

> (4) whether the transaction is one in the ordinary course of the business of the trustee; (5) whether the trustee is disposing of the property for much less than its real value; (6) whether the third person knows or has reason to believe that the trustee is dealing with the property for his own benefit; (7) whether the third person is purchasing the property or engaging in some other transaction with the trustee, as for example where he is making a payment or conveyance to the trustee . . . or is acting as depository of trust funds . . . or is a corporation registering a transfer of securities . . . or is engaged in some other dealings with the trustee. . . .

Although we recognize that this Restatement is restricted in its application to ordinary personal trusts, *see id.* § 1, Comment 6, the standards governing both restitutional duty, *see id.* § 288, and notice, *see id.* § 297, are similar to those of the Restatement of Restitution discussed above. *See* pages 1031–1032 *supra.* This multifactor test thus provides appropriate and helpful guidance in resolving the issue of notice.

45. *Bolton v. Gramlich, supra,* is not to the contrary. In *Bolton,* this Court held that a trustee's financial stake in the SFREI transaction prevented him from being "disinterested" for purposes of determining whether there existed a sufficient number of disinterested trustees whose knowledge could be attributed to the trust in order to avoid a finding of trust deception under the securities laws. *Id.* at 838–39. The decision indicates, however, that this deter-

mination was not relevant to a determination of the trustees' legal voting power under the Declaration of Trust. *Id.* at 839 n. 24 ("In this derivative action under Rule 10b–5, we are concerned with whether the trust was deceived, not with whether the actions were properly authorized by the vote.").

46. Although the intended scope of this provision is not absolutely clear, we reject defendants' proffered interpretation of § 14. *See* Defendants' Reply Memorandum of Law, at 75–76. Defendants simply ignore the second paragraph of § 14 quoted previously in text, instead focusing solely on the first paragraph dealing with purchases and sales of assets between the trust and the trustees. The interpretation described in text is consistent with this Court's prior interpretation of the clause. *See Bolton v. Gramlich, supra,* 540 F.Supp. at 838.

47. We note that under plaintiff's construction of the Declaration of Trust, no sale of property, nor any other management and legal fee-generating transaction, for that matter, could ever have been approved so long as Stamper remained a trustee; his "interest," coupled with that of the Gramlichs', would have prevented the necessary majority approval.

48. Defendants do not contend that they were unaware of either the aforementioned restrictions in the Declaration of Trust or the Gramlichs' indirect interest in the sales transaction.

Appendix F

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

SAME TITLE

MOTION FOR SANCTIONS FEES AND COSTS AGAINST SFREI AND ITS ATTORNEYS
82 Civ. 7920 (LBS)
NOTICE OF MOTION

PLEASE TAKE NOTICE that upon the attached Memorandum and Appendix submitted herewith, and all prior proceedings, plaintiff Terrydale Liquidating Trust ("TLT") will move this Court, at the United States Court House, Foley Square, New York, New York on Thursday, July 9, 1987 at 2:15 P.M. or as soon thereafter as counsel can be heard, for an Order awarding plaintiff sanctions, fees and costs, and such other and further relief as the Court sees fit, against San Francisco Real Estate Investors, ("SFREI") and its attorneys, the law firms of Skadden, Arps, Slate, Meagher & Flom, Landels, Ripley & Diamond and Rogers & Wells. The motion for sanctions, including denial of any award to SFREI for its attorneys' fees & expenses and including an award to TLT of its attorneys' fees and expenses incurred because of SFREI's and its attorneys' misconduct, is made pursuant to

Fed. R. Civ. P. 11, 28 U.S.C. sec. 1927, N.Y. Jud. L. sec. 487 and the court's inherent equitable power.

Dated: Garden City, N.Y.
June 22, 1987

Respectfully submitted,

LEVENTRITT LEWITTES & BENDER

By_____
(Member of the Firm)

Attorneys for Plaintiff Terrydale Liquidating Trust

TO:

SKADDEN, ARPS, SLATE, MEAGHER & FLOM
Attorneys for the Defendants, Counterclaimant and Third-Party Plaintiff

Appendix G

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

SAME TITLE

NOTICE OF MOTION

PLEASE TAKE NOTICE that upon the attached Memorandum of law, the affidavit of Sidney Bender, and all prior proceedings, plaintiff Terrydale Liquidating Trust will move this Court, in Room 443 at the United States Court House, Foley Square, New York, New York on Thursday, August 20, 1987 at 2:15 P.M or as soon thereafter as counsel can be heard, for an Order for discovery from SFREI of:

(i) all documents, including without limitation all checks, relating to agreements to make payment or payment, should read to make payment or payment, directly or indirectly, on behalf of SFREI, for any legal fees of the former trustees of TRT, Michael Gramlich and James Kostoryz, in connection with their deposition and trial testimony in this action;

(ii) all documents, including without limitation all checks,relating to agreements to make payment or payment, directly or indirectly, on behalf of SFREI, for any legal fees, expenses and lost time of Roger Bloom, John Fletcher and John Ernst in connection with their deposition and trial testimony in this action;

(iii) deposition discovery of a person or persons with knowledge of the relevant facts; and

(iv) such other and further relief as the Court sees fit.

Dated: Garden City, N.Y.
August 7, 1987

Respectfully submitted,

LEVENTRITT LEWITTES & BENDER

By_____
(Member of the Firm)

Attorneys for Plaintiff Terrydale Liquidating Trust

Appendix H

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

SAME TITLE

AFFIDAVIT OF
DOUGLAS M. KRAUS
82 Civ. 7920 (LBS)

STATE OF NEW YORK
: ss.:
COUNTY OF NEW YORK

DOUGLAS M. KRAUS, having been duly sworn, deposes and says:

1. I am a member of the Bar of this Court and of the firm of Skadden, Arps, Slate, Meagher & Flom, attorneys for defendant San Francisco Real Estate Investors ("SFREI") and its directors in the above-captioned action.

2. I make this affidavit in opposition to the application of plaintiff Terrydale Liquidating Trust ("TLT") to reopen discovery in this case so that it can investigate its theory that SFREI had "improper dealings" (TLT Memorandum, at 1) with certain witnesses in this case, in violation of the federal anti-bribery statute, 18 U.S.C. § 201, and the Code of Professional Responsibility. As shown below and in SFREI's accompanying memorandum of law, TLT's allegations are wholly without merit. Its motion is also untimely by nearly a year.

3. The witnesses who TLT accuses SFREI of "tampering with" (TLT Memorandum, at 2) are (i) the five former trustees of Terrydale Realty Trust ("TRT"), and Michael Gramlich and

James Kostoryz, employees of Terrydale Management Company, and (ii) John L. Ernst and John Fletcher, III, employees of the Bloomingdale interests, and their counsel, Roger Bloom, Esq. (These constitute all of the witnesses who testified in this action, other than the parties' experts and my two partners, Michael B. Goldberg and Jeffrey W. Tindell, who were called by TLT.) TLT claims that SFREI "corrupt[ed]" these witnesses (TLT Memorandum at 3), by paying for their attorneys' fees and expenses, and compensating them for lost time. TLT's claims are false.

4. SFREI made no payment of any nature whatsoever to Messrs. Bloom, Fletcher or Ernst, or any person or entity with whom they are affiliated, either for their attorneys' fees or expenses, or for anything else in connection with this action.

5. SFREI did, however, pay the fees and expenses of the Williams & Connolly and Polsinelli, White & Vardeman law firms for representing the former TRT trustees (and presumably Michael Gramlich and James Kostoryz as well) in connection with their preparation for and testimony at the trial of this action. Williams & Connolly submitted a statement dated July 3, 1986 in the total amount of $26,714.15, covering $25,000 in fees and $1,714.15 in disbursements. SFREI paid this bill by check on July 31, 1987. The Polsinelli firm submitted a statement dated July 28, 1986 in the total amount of $25,052.33, consisting of $17,490 in fees and $7,562.33 in disbursements. SFREI paid this bill by check on August 27, 1986.

6. These payments were made pursuant to discussions I had, prior to the commencement of the trial of this action, with Steven M. Umin, Esq, of the Williams & Connolly firm and David Welte, Esq. of the Polsinelli firm. They each indicated that they doubted that their clients would be willing or able to pay the legal fees and expenses that would be incurred for preparing them for their testimony and representing them at the trial, and inquired whether SFREI would be willing to pay these fees and expenses. I asked Mr. Umin about the $10,000 amount provided, in the December 1982 settlement agreement between TLT and the former TRT

trustees and other "Gramlich Defendants," for payment of these persons' future attorneys' fees, but I was told that this sum had been exhausted, due largely, if not entirely, to the third-party action commenced against the former trustees and others by SFREI in the fall of 1983 and the request for admissions served upon them by SFREI shortly thereafter.

7. SFREI believed that the former TRT trustees should have the benefit of Messrs. Umin's and Welte's counsel in connection with their testimony at the trial, since these lawyers were thoroughly familiar with the background of this action and because they were well known to the former TRT trustees and had represented them previously in this litigation or predecessor actions. Accordingly, although no formal agreement was ever entered into, SFREI authorized me to assure Messrs. Umin and Welte orally that SFREI would reimburse them for their reasonable trial-related fees and expenses, provided, in the case of Mr. Umin, that such fees did not exceed $25,000. I do not recall whether any such "cap" was discussed with Mr. Welte.

8. In my conversations with Messrs. Umin and Welte, there was never any discussion, nor even the faintest glimmer of a suggestion, that SFREI's willingness to cover their fees and expenses was contingent in any way upon the testimony of their clients or the outcome of the trial. We simply indicated our willingness to "backstop" their fees and expenses, assuming they could not otherwise get paid, because we believed it was appropriate that the former TRT trustees be represented at the trial by independent counsel who had represented them in the past and were familiar with the background of this complex litigation.

9. Neither I nor anyone from my firm ever had any contact whatsoever with any of the former TRT trustees, Michael Gramlich or James Kostoryz, other than seeing and examining them in court at the trial of this action and at their depositions noticed by TLT. Similarly, no one connected with SFREI had any contact with these witnesses regarding this litigation or any testimony they might be called upon to give. Moreover, the trial testimony of

these witnesses, who were questioned extensively on this matter by TLT's counsel, makes clear that they were unaware that SFREI had agreed to pay Messrs. Umin's and Welte's trial-related fees and expenses, although they plainly did not plan to pay these fees and expenses themselves and expected that someone else would pay them. The relevant excerpts from their trial testimony are annexed hereto as Exhibits A-G.

10. I respectfully submit that these facts do not even remotely permit an inference that SFREI or anyone connected with it paid a bribe, in violation of 18 U.S.C. § 201, to a witness in this case in order to obtain testimony of any sort, or otherwise "corrupted" or "tampered with" any witnesses in this case. Nor did SFREI or anyone connected with it make or promise any payment to a witness, or anyone else for that matter, contingent upon the nature of such person's testimony or the outcome of the trial, in violation of the Code of Professional Responsibility. TLT's suggestions to the contrary are simply the latest in what has become a tiresome stream of frivolous motions intended to needlessly prolong this case and delay the entry of final judgment awarding SFREI its attorneys fees and expenses, to which this Court has found it is entitled.

Douglas M. Kraus

Douglas M. Kraus

Sworn to before me this
14th day of August, 1987

Steven Stark

Notary Public

STEVEN D. STARK
Notary Public State of New York
No. 24-4887129
Qualified In Kings County
Commission Expires March 9, 1989

Appendix I

Murphy-direct

(92) THE COURT: All right, you may proceed.

Q. Mr. Murphy, is it your understanding that your attorney's fees are being paid by Mr. John Gramlich or the Gramlichs generally? A. I don't know who is paying them.

THE COURT: But you know that you are not?

THE WITNESS: I know that I am not. I hope that I am not.

Q. Do you have any understanding as to who is paying them? A. None whatsoever.

* * *

Murphy-redirect

* * *

(209) Q. Is there some agreement that you have with the Gramlichs, Mr. Murphy, that you are not to pay any attorneys' fees in connection with defending the actions that were brought against you? A. I don't believe I have any agreement with the Gramlichs. I have been told that my attorneys' fees are going to be paid.

Q .Who told you that? A. One of the attorneys.

Q. Which attorney?

MR. KRAUS: Your Honor, I object now. He is invading the privilege here.

THE COURT: Sustained.

Q. Did Mr. Gramlich ever tell you that he was going to pay your attorneys' fees? (210) A. No.

Murphy-redirect

Q. Did you ever have any discussions with Mr. Gramlich about his paying your attorneys' fees? A. No.

THE COURT: I take it that whenever we say Gramlich, we are referring to John?

MR. BENDER: That's correct.

* * *

O'Flaherty-direct

* * *

(444) Q. Mr. Welte is representing you today, is he not, as your attorney? A. Mr. Welte is one of the attorneys I have been talking to. Whether he is representing me, I really don't know, Mr. Bender.

Q. You never have contracted with Mr. Welte to engage him to render services to you? A. No, I have not, sir.

Q. In fact, you haven't engaged any attorney to represent you here today; is that right? A. That's correct, Mr. Bender.

Q. Do you know who is paying for the attorneys who are appearing here, Mr. Welte and Mr. Umin? (445) A. All I know is, I'm not paying it, Mr. Bender.

Q. Have you inquired as to who is paying? A. Yes, I had, sir.

Q. What have you been told? A. I have not been told anything, sir.

Q. Isn't that a little strange to you, Mr. O'Flaherty? A. There's lots of strange things in life. I just did not pursue the matter because I am certainly not involved. The money is not out of my pocket, Mr. Bender. I imagine if I had to spend some

money out of my pocket for attorney's fees, I would be a little bit more cautious, a little bit more concerned. But that's not the case with me.

O'Flaherty-direct

Q. Did you understand that Mr. Gramlich, John Gramlich, was paying— A. No, sir, not at all.

Q. Did you understand that San Francisco was paying the attorneys? A. Sir, I don't know who is paying the attorneys. I answered that.

* * *

Stamper-direct

* * *

(527) Q. Have you retained counsel for your appearance here today, sir? A. Have I retained counsel?

Q. Yes. A. By paying a fee?

Q. Yes. A. No, I have not.

Q. And you have been discussing this matter with Mr. Welte in the last few days, is that correct? A. Yes, I have.

Q. You have been discussing it with Mr. Steve Umin in the last few days, sir? A. Yes

Q. When did you come to New York? A. On Sunday afternoon.

(528) Q. And as I understand it, you have no obligation to pay the legal fees of Mr. Welte and Mr. Umin, is that correct? A. Not that I'm aware.

Q. Now have you inquired as to who is paying them? A. No.

Q. Do you know whether San Francisco Real Estate Investors is paying them? A. No, I don't.

Q. You have no understanding as to who is paying them? A. No, I don't.

Stamper-direct

Q. And you made no inquiry? A. The only inquiry I made was the expenses of coming to New York and staying here and I understand that you are paying those or your clients are paying those.

Q. That is right. And that's under the settlement agreement, right, Mr. Stamper? A. Yes, sir.

Q. Have you conferred with me since you have been in New York? A. No.

* * *

(745) THE COURT: But your present understanding is that counsel will not look to you personally for compensation for your representation?

THE WITNESS: Exactly. I am not expecting to together pay counsel for representing me in this matter.

* * *

Kostoryz-direct

* * *

(1138) THE COURT: . . .

* * *

Are you now represented by an attorney?

THE WITNESS: I am not sure, frankly. It seems that David Welte, with the firm of Polsinelli, has been on the scene here, but as far as who—no, I don't (1139) know.

Q. Did you contract to retain David Welte or the Polsinelli firm? A. No.

Q. Have you been conferring with him as though he were your attorney? A. In New York here, yes.

Kostoryz-direct

Q. And was that in the presence of other people? A. Yes.

Q. Who else was present at the time? A. John and Mike and Russ Gramlich.

* * *

(1169) M. Gramlich-direct

* * *

Q. Your deposition was taken in this matter, isn't that correct? A. Two years ago, yes.

Q. And you were represented at that deposition by David Welte? A. Yes.

Q. Were you paying David Welte? A. I don't remember who was paying David Welte.

Q. Do you have any understanding as to whether or not David Welte is being paid by San Francisco Real Estate Investors? A. I know we had an agreement, but I don't remember what it was, I don't remember how we had that set up.

* * *

(1170) Q. Sir you just referred to you believed there was an understanding. What was your belief as to the understanding with respect to San Francisco?

MR. KRAUS: I object, your Honor.

A. Regarding what?

Q. Regarding the payment—was there any understanding by you that your legal fees or the fees of Mr. Welte were going to be paid by San Francisco? A. Not to my knowledge, no.

M. Gramlich-direct

Q. Did you understand that your father was paying the legal fees of the other trustees of TRT in this matter?

MR. KRAUS: At what time is that question directed to?

THE WITNESS: Yes.

Q. At any time. A. At any time?

Q. Yes. A . No, not to my knowledge.

Q. Do you have any understanding about that as to who was paying the—A . No.

Q. And you have no understanding as to who was paying Mr. Welte on your behalf? A . No, I don't

Q. Do you understand it was your father? A . If it was— is that the way you understand it? I don't know what you are trying to tell me or ask me.

Q. I want to know what you understand as to who is paying Mr. Welte for rendering legal services on your behalf.

MR. HENDERSON: Asked and answered, your Honor.

THE COURT: I will allow it

A. I—I don't know.

* * *

J. Gramlich-direct

(1200) Q. That includes Mr. Umin's representation here last week? A. No, that was $30,000 up until he came up here the last two weeks.

* * *

Q. And is it your understanding that Mr. Umin is going to be sending you personally, you and your brother Michael personally a bill for his services in the last two weeks? A . He has already sent us bills.

Q. That is addressed to you personally and your brother Michael? A . Yes, it's addressed to me because I had the agreement with him.

Q. So it's addressed to you? A . But I am hoping my brother will kick in with me.

Q. As far as the bills from the Polsinelli firm, that is being paid by your father? A. Wait a minute, I said up through the discovery period.

Q. How about at the trial? A. Now, right now I told the Polsinelli firm, I said we are not going back there and paying any more legal bills unless somebody pays these legal bills, (1201) and David Welte told me he said, "I will try and work something out with San Francisco to see if they will kick in some money on this. Otherwise you will be responsible. "

Q. Did Mr. Welte report any conversations to you with the San Francisco people? A. No, he didn't. I don't know whether he made a deal with them or not.

Q. What you are now talking about related to the legal bills for Mr. Welte's representation here at the trial? A. Yes.

Q. But as far as Mr. Welte's representation of the former trustees and your father and yourself and Michael during the depositions, during discovery, and whatever else was involved, that was—those bills have already been paid and they have been paid by your father? A. Yes, they have, except for Mr. Umin's bills.

Q. Except for Mr. Umin's bills? A. Yes.

Q. And those you testified to that is your personal obligation? A. Yes.

Q. So Mr. Umin's firm and then at the trial, that is also your personal obligation to Mr. Umin's (1202) firm? A. Yes.

Q. Did you make that known, that fact known to the former trustees when they were here testifying, sir? A. No, I didn't see two of them.

Q. But the one—which one did you see, Mr. Stamper? A. Yes, I saw him, let's see, the first week that I was up here, and then I saw him the first part of this week.

Q. Did you make that fact known to him? A. What our arrangement was?

Q. Yes. A. No.

Q. Did you ever discuss it with him? A. I don't recall discussing it with him.

Q. I am now only talking about at the trial. A. No, I don't recall discussing that with him.

Q. Did he ask you at any time, I just want to be sure that I am not responsible for these legal fees? A. I don't think he did. I think they all—well never mind.

Q. They all just assumed that you were going to be taken care of it? A. I think they all felt that the Gramlichs (1203) would work something out to make sure that it was all taken care of.

* * *

(1257) Q. Is it your understanding Mr. Gramlich, that if San Francisco wins this lawsuit, Mr. Welte's next legal fees are going to be paid by San Francisco?

J. Gramlich-direct

MR. KRAUS: Objection, your Honor. This is beyond the scope of the cross-examination.

THE WITNESS: Should I answer that?

THE COURT: Yes, you may answer that.

A. I don't know who's going to pay them.

* * *

J.R. Gramlich-direct

(1448) Q. Sir, have you been told that Mr. Welte is attempting to have San Francisco pay the legal fees for his appearance here at the trial? A. Let me say, I hope so.

Q. Pardon me? A. I hope so.

Q. You expect so, is that it, if they win? A. I just, I just hope they pay him.

Q. You think they should pay him if they win?

THE WITNESS: Do I think they should pay them if they win? What if they lose?

THE COURT: You are asking me whether—you have to answer the question.

MR. KRAUS: I am objecting, your Honor.

THE COURT: Yes, sustained.

THE WITNESS: All right.

* * *

Appendix J

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

SAME TITLE

AFFIDAVIT OF
STEVEN M. UMIN
82 Civ. 7920 (LBS)

CITY OF WASHINGTON
DISTRICT OF COLUMBIA } ss:

STEVEN M. UMIN, being duly sworn, deposes and says:

1. I am am member of the firm of Williams & Connolly. My firm represented the former Trustees of Terrydale Realty Trust ("TRT") in 1981 at the time of the tender offer for TRT shares by BCG Associates ("BCG"). We also represented the former TRT Trustees and other members of the Gramlich family (the "Gramlich Defendants") in connection with the litigation brought against them in this Court by BCG and its principals (and later by Terrydale Liquidating Trust ("TLT"), the successor to TRT).

2. In December 1982, the Gramlich Defendants settled all of the claims against them in the above-described litigation. The settlement agreement, among other things, provided that the Gramlich Defendants would, if required by TLT, appear in person at the trial of this action.

3. Shortly before the trial of this action, it became apparent that our assistance would be required in the preparation of the former TRT Trustees for their trial testimony. (We were never involved in the preparation of Michael Gramlich or James Kos-

toryz at the trial.) The events in question had occurred years earlier and there were a large number of relevant documents and details which needed to be reviewed. Accordingly, I inquired of Douglas M. Kraus, Esq., a member of the firm of Skadden, Arps, Slate, Meagher & Flom, counsel for defendant San Francisco Real Estate Investors ("SFREI"), whether SFREI would be willing to pay our firm's reasonable fees and expenses in connection therewith. I told Mr. Kraus that I would not request any additional fees from our clients.

4. Mr. Kraus ultimately advised me that SFREI would not object to a request by our firm for reimbursement of its fees and expenses in this matter, provided that our fees did not exceed $25,000. On July 3, 1986, after the former TRT Trustees had testified and our work on this matter had concluded, I submitted a statement to Mr. Kraus in the total amount of $26,714.15, covering $25,000 in fees and $1,714.15 in disbursements. SFREI paid this statement by check dated July 31, 1986.

5. In helping to prepare the former TRT Trustees, I, and the other member of my firm who worked with me, acted completely independently at all times. No one connected with SFREI attempted to influence the testimony of our judgment or conduct in any respect. In my discussions with Mr. Kraus concerning our fees, there was never any suggestion that the payment of our fees was contingent in any respect upon the content of the testimony of the former TRT Trustees or upon the outcome of the litigation. In fact, our fee was paid nearly four weeks before the Court rendered the decision in this case.

6. Prior to and during the trial, I did not discuss with any of the former TRT Trustees the question of payment for legal fees and expenses. At the time of the trial, I believe they were totally unaware of how these fees and expenses would be paid.

_____

Steven M. Umin
(Sworn to August 14, 1987)

Appendix K

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

SAME TITLE

AFFIDAVIT OF
DAVID A. WELTE
82 Civ. 7920 (LBS)

CITY OF WASHINGTON }
STATE OF MISSOURI } ss:

DAVID A. WELTE, being duly sworn, deposes and says:

1. I am a member of the firm of Polsinelli, White, Verdeman & Shalton, P.C. My firm has for many years represented the Gramlich family and Terrydale Management Company, which was the advisor to Terrydale Realty Trust ("TRT") until control of TRT's successor Terrydale Liquidating Trust ("TRT") was assumed by the principals of BCG Associates in early 1982. My firm also represented the former TRT Trustees and certain members of the Gramlich family when their depositions were taken in this action by TLT in 1984. Our fees for preparation for and attendance at these depositions were paid by the Gramlich family.

2. Several weeks before the trial of this action, I spoke with Douglas M. Kraus, Esq., a member of the firm of Skadden, Arps, Slate, Meagher & Flom, counsel for defendant San Francisco Real Estate Investors ("SFREI"), concerning my firm's representation of the former TRT Trustees, Michael Gramlich and James Kostoryz, with respect to their testimony at the trial of this action. I told Mr. Kraus that these people were expecting us to assist them in preparing for their testimony and to be present when they

testified at the trial in New York. However, I also explained to Mr. Kraus that I did not believe that our clients would be willing or able to pay our firm's fees and expenses in connection with this representation, and asked him whether SFREI would be willing to pay our fees and expenses.

3. After consulting with his client, Mr. Kraus advised me that SFREI would agree to reimburse our firm for its reasonable fees and expenses in matter. He did not indicate what he meant by the term "reasonable", although I later learned that SFREI had imposed a $25,000 "cap" on the Williams & Connolly law firm for their services in representing the former TRT Trustees at the trial. Our bill for this matter dated July 28, 1986 totaled $25,052.33, consisting of $17,490.00 in fees and $7, 562.33 in expenses.

4. In advising the former TRT Trustees, Michael Gramlich and James Kostoryz, I and the other lawyers at my firm who worked with me acted completely independently at all times. No one connected with SFREI attempted to influence my judgment or conduct in any respect, and they could not have done so even if they had tried. In my discussions with Mr. Kraus concerning our fees, there was never any mention or suggestion that the payment of our fees was contingent in any respect on the content of the testimony of our clients or the outcome of the litigation. In fact, our statement for services rendered was sent to SFREI on July 28, 1986, about four weeks before the Court rendered its decision in this case. Although SFREI's check to my firm in payment of our statement was dated August 27, 1986, the day after the date of the Court's decision, Mr. Kraus had advised me previously that our statement had been approved and would be paid in due course.

5. I do not recall our clients asking me who was paying our fees, and I certainly never told any of them that I expected that SFREI would pay our fees. Prior to my discussions with Mr. Kraus, John Gramlich had asked me whether it would be possible to get someone else to pay our fees and expenses. I told him that TLT would be paying the traveling expenses of the former TRT

Trustees, Michael Gramlich and James Kostoryz, pursuant to the December 1982 settlement agreement with TLT, and that I would inquire whether SFREI would be willing to pay my firm's fees and expenses in connection with the trial. However, Mr. Gramlich never subsequently asked me whether I had been able to work out any arrangement with SFREI. I never told him that SFREI had indicated its willingness to cover our fees and expenses, and I believe that he and our other clients were unaware of this fact at the time of the trial. Before billing SFREI, however, I did inform John Gramlich that SFREI had agreed to pay our and Mr. Umin's firm's fees and expenses in connection with the trial, and our clients were very pleased with this arrangement.

David A. Welte
(Sworn to August 14, 1987)

* * *

Appendix L

ROGERS & WELLS
Two Hundred Park Avenue
New York, N.Y. 10166

July 31, 1987

The Honorable Leonard B. Sand
United States District Judge
Southern District of New York
United States Courthouse
Foley Square
New York, New York 10007-1581

Re: *Terrydale Liquidating Trust* v. *Barness, et al.*,
Civ. 7920

Dear Judge Sand:

This Firm joins in the opposition to the motion of Terrydale Liquidating Trust for sanctions, fees and costs submitted by Skadden, Arps, Slate, Meagher & Flom dated July 30, 1987. For all of the reasons stated in that memorandum, it is respectfully urged that the sanctions motion should be denied in all respects.

Sincerely,

John J. Sheehy

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Appendix M

LANDELS, RIPLEY & DIAMOND
Attorneys
450 Pacific Avenue
San Francisco, California 94133
(415) 788-5000

July 30, 1987

Via Federal Express

The Honorable Leonard B. Sand
United States District Judge
Southern District of New York
U.S. Courthouse, Room 626
New York, New York 10007

Re: *Terrydale Liquidating Trust* v. *Barness, et al.*
(San Francisco Real Estate Investors) No. *82* Civ. 7920 (LBS)

Your Honor:

This firm was formerly co-counsel of record for defendant San Francisco Real Estate Investors and its trustees ("SFREI") in this litigation, from its inception until the latter part of 1984. At that time SFREI was merged into another entity and ceased to exist. Thereafter, the Skadden, Arps firm continued on as sole counsel to SFREI.

After three years' absence from the case, we recently received a copy of plaintiff's motion to levy sanctions against SFREI, Skadden, Arps, Rogers & Wells (a former counsel of record like ourselves), and this firm. I was personally and professional shocked to learn that we were now being accused of having

committed a fraud and deceit on the Court. Although no longer associated with this case, I respectfully request the opportunity to address the Court on these issues on behalf of my firm and myself.

I was admitted to practice in the Southern District of New York in this case *pro haec vice*, as I had been on previous occasions when my clients' interests so required. My admission was moved by the firm of Roger & Wells, based upon my personal credentials and experience in federal practice. As a graduate of Columbia Law School, I was also familiar with New York state procedural law, which became particularly helpful in this case.

Plaintiff now alleges that six years ago I and other members of my firm lied to the court and counsel, and deliberately so. Plaintiff takes issue with arguments made in support of SFREI's motions to dismiss for lack of personal jurisdiction in this and in an earlier case (*Bolton* v. *Gramlich*, 81 Civ. 2806), which was dismissed four and a half years ago.

We strenuously object to plaintiff's allegations. We understand that they have been made before in this case, and that the Court has twice disposed of them as lacking any merit. For all the reasons previously set forth by counsel to SFREI on those occasions, we submit the allegations continue to be improper.

I can assure the Court that neither I nor any member of my firm has ever embarked upon a course of fraud and deceit on the Court. This firm enjoys a long and fine reputation in the federal courts, both in California where we regularly practice and in other courts where we have been privileged to be admitted. At no time have I or any other member of my firm knowingly, intentionally or deliberately misled this Court in this or any other case before it. I never interposed any defense for an improper purpose, nor for delay, harassment or to increase the cost of litigation. I have at all times conducted my representation of SFREI in this case in good faith. I am distressed that these allegations would arise now, six years after the fact and long after our involvement in this case has

ended. If not out of malice, I can only assume they are made out of desperation. In either event they are wrong.

I respectfully request that the Court deny plaintiff's motion. Although no longer involved in this case, I offer this letter as an affidavit, to the extent the Court may deem that necessary in order to include it as part of the record. In that event, I declare under penalty of perjury that the facts stated in this letter are true to my knowledge and that I signed this letter on the date and at the place stated above.

Respectfully submitted,

Harvey L. Leiderman

Harvey L. Leiderman

HLL: sh

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Appendix N

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

SAME TITLE

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* * *

August 27, 1987
2:15 p.m.

Before:

HON. LEONARD B. SAND,

District Judge

* * *

(3) MR. BENDER: Your Honor, there are three matters before your Honor today, two of which are on behalf of the plaintiff, one motion for sanctions and the second one for interfering with the plaintiffs' witnesses.

And I would like to address, if I may, those two sanctions, unless your Honor prefers to hear from Skadden first on the question of their revised fee application.

THE COURT: I want to hear and possibly decide all matters in the area. Terrydale must come to an end at some point, and I think that that point, if not past, has certainly been arrived at.

So you may proceed.

MR. BENDER: Yes, your Honor.

Your Honor, the first motion of the plaintiff is one for sanctions, and that is broken down into two distinct parts, one in which we request sanctions under Rule 11, section 1927, and the Judiciary Law, Section 487. Under that we are asking for attorneys' fees and we are asking for a tripling of those attorneys' fees, under the Judiciary Law, Section 487, for the misconduct of San Francisco and its attorneys, conduct that clearly represented a withholding of material and critical facts from this Court at the time that it was (4) advising this Court that there was a transaction of no business in New York State whatsoever. The facts have been clearly laid out by us, your Honor.

THE COURT: But, you see, I lived with this issue now over and over again, and when I considered the issue on the merits and when I considered the issue when it was raised again in connection with the fee application, I considered all of the implications of that issue and what actions were appropriate.

As you point out in your papers, which I have read, Rule 11 is not merely triggered by an application by a party but it is something which the Court has an obligation to consider sua sponte; and in determining what the consequences should be for the making of that motion, which I think I characterized as being devoid of merit, I considered the full spectrum of possibilities, including the availability of Rule 11, and I denied fees in connection with that matter. I denied your contention that the consequence of that should be to deprive the plaintiff's counsel of any entitlement to fees.

So here we are again for the third time, and you nibble and nibble at the issues, which is why I prefaced my remarks by saying that there has to be an end to this. Finalize this case in the court, go (5) to the Court of Appeals or do whatever else you think is appropriate, but I don't see the utility to returning again and again to essentially what are the same issues.

MR. BENDER: Your Honor, may I just say in that connection that I appreciate the fact, your Honor, that the issue was

raised in connection with your decision before October 26, 1986, on the question of liability and attorneys' fees.

As your Honor recalls, it was your decision of April 15, 1987 in which your Honor found that the defense was entirely devoid of merit. And in the October 26 decision, your Honor, we did not submit in a detailed, pattern-like fashion what really occurred.

This was not a situation, as it was portrayed in your October 26th papers, where it was a one-shot motion whereby here was a failure of Mr. Chappell to disclose the facts to the Court. We then, in our submission today, or in connection with the motion that is being now heard, demonstrated it was just SFREI that was failing to make its critical disclosure to the Court, it was the attorneys for SFREI who time and time again, on three separate occasions, finally got this Court to dismiss the case on the ground of lack of jurisdiction, and it was counsel who improperly argued to this Court and concealed from this Court critical facts which made (6) it obvious that there is jurisdiction.

There would not have been a dismissal of the complaint, there would not have been a long waiting period before discovery began on the issues against San Francisco, because they constantly came back, time and time again, with a pattern of deception and actual fraud by not revealing to your Honor critical facts which made it obvious that there was jurisdiction over San Francisco. There would not have been the deliberation by your Honor on four or five separate occasions, all at the behest of San Francisco, all based upon false statements in their papers.

Now, your Honor, this is just not a situation where the plaintiff has been harmed. this is a deception on the Court, on your Honor as a representative of the judiciary, and on the taxpayers, who pay your salary and who keep this court in being, and they have taken the time of this Court, playing with this Court as if it was a toy in time and time again attempting to prevail on an issue and finally getting the matter dismissed, your Honor. And it was

only because we kept persisting that your Honor finally gave us discovery of Skadden, Arps and all the facts then came out.

And Skadden, Arps was sitting on critical facts which, if disclosed, would have made it obvious (7) that there was no merit to the claim of personal jurisdiction.

Now, no officer of this court should be permitted to withhold from this Court pertinent information, come in and seek a protective order and claim that the plaintiff is on a fishing expedition when it knows and has in its possession critical facts which, when disclosed—they didn't even attempt to make a motion after we took their deposition, they didn't even attempt to make a motion to dismiss for lack of personal jurisdiction, because they knew they had executed in New York a critical document which stated that they were authorized to execute it on behalf of San Francisco and which they led this Court to believe was not in fact executed, because they told this Court there was an isolated telephone call, that's what the defendants had said, there was an isolated telephone call into New York City by George Mann in Toronto. Instead, contracts had actually been executed here in New York which were so critical to the entire transaction that but for that discussion the transaction would not have gone through.

Now, under those circumstances, your Honor, it brings a court into disrespect if these defendants and their attorneys can proceed on a process of deception and fraud on the Court and get away with only allowing (8) or disallowing them their attorneys' fees, for that conduct.

This puts a premium upon misconduct and, furthermore, it demonstrates, as the courts have said in Cable Marine, as the Fifth Circuit said, when conduct is so unreasonable and inequitable, it will not, even under those circumstances, enter an award for attorneys fees under a contract.

In the Silbiger case, Judge Learned Hand said that where a lawyer is guilty of professional misconduct they will bar the award of attorney's fees to that attorney.

Now, what is San Francisco really getting here? They are getting an award of attorneys' fees for its representation by Rogers & Wells, Landels Ripley and by Skadden, Arps, all three of whom—

THE COURT: Now you are literally rearguing your prior application, which was that the conduct of SFREI in connection with the jurisdictional motion should deprive SFREI of attorneys' fees.

Now you are four square in what we have previously argued.

MR. BENDER: Not so, your Honor, because we never made the statement in that previous argument that it was the attorneys' fees of lawyers who had misrepresented to this Court. We did not take that position, (9) your Honor, in that earlier statement. And that is the thrust of what we are saying.

THE COURT: You are assuming that the Court's query and the Court's perception of these issues is limited to literally what you said. And what I'm trying to convey to you, because it is relevant not only to this but to some of the other issues which you've raised, is that this Court has spent an inordinate amount of time on this case and has not confined it scrutiny of the facts and of the issues to the four corners of your papers.

MR. BENDER: But nonetheless, your Honor, we recognize how busy your Honor is—

THE COURT: I'm not complaining about how busy I am. What I am suggesting is that there is failure to accept the Court's determinations and seek appellate review of them, but what there is in this case, and one sees it on both sides in some of the applications that are made, is a prolongation and exacerbation of the controversy, which is not helpful.

Is there anything more you want to tell me on the merits of your Rule 11 application?

MR. BENDER: Yes, your Honor. I would like to just state to your Honor that the Supreme court, in the National Hockey

League case, said that the purpose (10) is not merely to penalize the person against whom sanctions are warranted but the purpose is also to deter those who would be induced or may be considering conducting themselves in an improper fashion.

And with all due respect to your Honor's ruling, if your Honor wants to rely upon that ruling in this connection, I would say this to your Honor: that what has happened here in terms of the disallowance of attorney's fees for that issue, as to which the parties attempted to deceive and practice a fraud on the Court, is merely to slap these people on the wrist and to say "Go back and try it again," and nothing has happened to them.

There hasn't been any real penalty that would deter anybody. In fact, it puts a premium, if your Honor please—

THE COURT: You said that already.

MR. BENDER: Well, your Honor, I believe that in terms of the facts here that this is a situation where, under Rule 11, the defendants knew that their defense was not well grounded in facts.

The conduct that we are talking about went way beyond that. This was active deception, what I think is brought out in the present motion, which is different than the previous motion. We only brought (11) it out in the situation where Mr. Chappell filed a false affidavit and Mr. Lederman argued improperly and falsely to your Honor.

We have now documented all those motions in which there was a repeat of this position before your Honor, so that it represented briefs on four or five motions and then a dismissal, if your Honor please. And that goes far beyond what Rule 11 talks about today, because Rule 11 today is objective. And actually, as far as Rule 11 is concerned, with all due respect to your Honor's ruling, in which you said your Honor did understand, of course, that sua sponte he is obligated to impose sanctions against counsel, their attorneys, I would submit to your Honor that, if Rule 11 imposes a directive to your Honor to award sanctions, that if the sanctions

are only the elimination of their attorneys' fees on that area in which they attempted to deceived the Court, that that does not comply with Rule 11, and I think the gravity of this situation is such that it calls for far more than that.

THE COURT: I think you made your position clear. Suppose I hear from counsel for SFREI on that issue and then we will deal with the other issues.

MR. BENDER: Your Honor, could I say one other thing?

(12) THE COURT: Yes.

MR. BENDER: I believe that the sanctions that should be imposed for this area is not only the sanctions that are required by Rule 11, Section 1927 and Section 487, but I believe, your Honor, that there should be no attorney's fees on this branch of the motion because of the fact of this misconduct, and based on the Silbiger case and the—

THE COURT: I don't understand when you say no attorneys' fees based on this branch of the motion.

MR. BENDER: In other words, we are arguing two things: sanctions under Rule 11, Section1927, and we are also saying, your Honor, that not only that but that they should be paying our attorneys' fees for our defense on this issue of jurisdiction, which your Honor has not touched on and which your Honor has not given any weight to whatsoever, because we incurred attorneys' fees in defending the issue of lack of jurisdiction and we are requesting that your Honor impose sanctions and award us our attorneys' fees.

Now, in addition to that.

THE COURT: Have you done an estimate of what your attorneys' fees were in resisting that motion?

MR. BENDER: Your Honor, we have not done it. We said we will submit our application, just like (13) your Honor took a two-step bite before, liability first and then followed by an application.

THE COURT: So we could go on and on.

MR. BENDER: Your Honor—

THE COURT: I understand. I understand

MR. BENDER: That's the way we did it before, your Honor, and I thought that was appropriate here.

We can submit that application within a short period, your Honor.

Secondly, your Honor, what we are saying to the Court is that the gravity of the misconduct is such that that brings into play the Precision Instruments case, the Silbiger case, and the National Hockey League and also the Cable Marine case. And in Cable Marine, the court said, where the misconduct is such that it is unreasonable and inequitable to award an attorney who has a contract attorneys fees, the Court will not allow any attorneys fees under the contract.

And that is our situation, and the misconduct was so unreasonable here—

THE COURT: I think you are getting a bit repetitious.

Mr. Kraus?

MR. KRAUS: Thank you, your Honor.

(14) Just two very brief points.

First of all, these charges of fraud and deceit roll very lightly off Mr. Bender's tongue, and I don't want the Court to think for a moment that we concur in these claims or give them the slightest amount of credence. We were not counsel, my firm was not counsel, for SFREI at the time this motion was made. But the lawyers who were deny and dispute these allegations. They submitted letters to your Honor which I think make that clear.

Mr. Bender is accusing me of fraud and deceit because I signed an answer in which the personal jurisdiction defense was preserved, and we dispute strenuously that that constitutes any

sort of fraud or deception. And I don't want to prolong or elongate this, but even the characterizations of Mr. Bender's claims as baseless, as a sham are not even accepted by him as a denial. And I just want to make it very clear on the record that we dispute these allegations.

And if the Court has any thoughts of ever entertaining the merits of such a claim, I would be pleased to report in greater detail. But I think we put it all in our papers.

Secondly, this is something, as your Honor I think is well aware, that was argued previously to (15) the Court, and we don't see where, in the rules, the plaintiff has the right to say "Now, well, I didn't put my best case forward before, or I reorganized the claims in some new way, and that gives me the right now to take a second bite of the apple."

We think this procedure is highly inappropriate, and it just evidences what the real purpose of this motion is, and that is that he spent six years telling this Court, or five and a half years telling this Court, about the enormous give-away of value in this case.

Your Honor put a big pin in that balloon last year when you decided the case on the merits in our favor, and on top of all that he is now facing a substantial award of attorneys' fees against him, and this is just a tactic to delay. And I appreciate your Honor saying that the case will end today because our position is that that is clearly the proper result.

THE COURT: All right.

Suppose I hear your second motion.

MR. BENDER: Your Honor, may I just make a rejoinder to that?

THE COURT: No, no. Suppose you direct yourself now to your second motion.

MR. BENDER: The second motion, your Honor. (16) is a motion for discovery based on defendants' improper dealings

with witnesses called by the plaintiff, namely we will call those witnesses the Gramlich defendants, which consisted of the former trustees of TRT.

THE COURT: You are moving under what? Under what theory are you moving for that discovery?

MR. BENDER: Your Honor, that there was a violation of the U.S. Code—

THE COURT: There are rules. There is Rule 60(b). There are rules for motions for a new trial. SFREI says that your motion is untimely.

MR. BENDER: Yes, your Honor.

THE COURT: What rule are you proceeding under?

MR. BENDER: Rule 54(b).

THE COURT: Under Rule 54(b) you want—

MR. BENDER: I am just citing that as an example, your Honor. Rule 54(b) says that until there is a final judgment, until there is a final judgment, in this action, your Honor—

THE COURT: —everything can continue?

MR. BENDER: Yes, your Honor.

Your Honor makes a joke. But the fact of the matter is that Rule 60(b) is not triggered until a final judgment is entered. And neither is Rule 59 (17) triggered until a final judgment is entered. And, we submit, Rule 59 is talking about a final judgment.

THE COURT: You are under the impression that until a final judgment is entered—

MR. BENDER: It is the law of the case doctrine.

THE COURT: The law of the case doctrine? I would think the last thing you would want to cite would be the law of the case doctrine.

MR. BENDER: I mean about the rule that the law of the case has ruled, that the Court has rendered a decision.

THE COURT: All right. You are telling me that is the procedural basis upon which you are making your motion?

MR. BENDER: No. that is not the procedural basis, because I am talking now about what your Honor was addressing, which was the timeliness and that this motion was out of season. And I submit, the motion is not out of season in light of the fact that we are not here dealing with a laches or statute of limitation question. If you want to say anything, even if you say under rule 59, the outside period that a party could make a motion as this would be ten days after the entry of a final judgment.

(18) After all, the defendants raised the issue in the Court of Appeals as to whether or not we had a final judgment to appeal from, and the parties all stipulated in the Court of Appeals that what your Honor entered on August 28, 1986 was not a final judgment that disposed of all issues in this case.

THE COURT: I have your answer to my question. Let's take the logical sequence of what would happen if I granted your motion and you conducted the discovery, and let's assume arguendo that the discovery from your standpoint was productive and supported all of the claims that you now make.

What would the next step be?

MR. BENDER: We would make a motion to set aside the immediate judgment of August 28.

THE COURT: On the ground of?

MR. BENDER: On the ground that you would then be viewing the evidence, your Honor, through different eyes, in this respect:

What was not made known to the Court was that there was a secret agreement, entered into by Skadden on behalf of the client, with the lawyers for witnesses that we had called.

THE COURT: You know, Mr. Bender perhaps I shouldn't say this, but I was the factfinder in this (19) case, and so I'm in a unique position to state what I was aware of and what I was not aware of and what factors I took into consideration.

Please give me the credit of some slight experience in the way the practice functions and the significance of a witness, who has an hourly rate of some substance, testifying that he anticipated that his fees and expenses would be met and would be paid for.

It certainly comes as no surprise to me that witnesses who testified, the professional witnesses that testified, anticipated that they would be reimbursed, nor the source of that reimbursement.

MR. BENDER: For their attorneys' fees, your Honor?

THE COURT: that isn't a—

MR. BENDER: There was no question but that their attorneys' fees were going to be paid. That was clear in the record.

THE COURT: Yes.

MR. BENDER: That their attorneys' fees were going to be paid. and the assumption was, based on everything that had been said before, that the attorneys' fees were going to be paid by the Gramlichs. And even though questions were asked about whether San Francisco was paying, nobody knew anything about that except Mr. (20) John Gramlich, who testified falsely, as it now appears, based on what we have now learned, who testified falsely that he was advised by his lawyer, his lawyer Welte, who said to him, "I will try and work out something, work something out with San Francisco to see if they will kick in some money on this. Otherwise you will be responsible," when in fact, according to the affidavits that have now been submitted, we Welte had an agreement with Doug Kraus on behalf of San Francisco that his attorneys' fees were assured to be paid by San Francisco.

Now, that's a different situation, your Honor. That's where the lawyer for our adversary was paying witnesses we called. It is called corruption of witnesses, if your Honor please.

Incidentally, this was kept secret from the Court, it wasn't brought out, no one knew this. Mr. Kraus was silent in the court even though he had a duty to apprise this Court of that agreement.

THE COURT: And—

MR. BENDER: And your Honor did know that.

THE COURT: Well, the underlying premise that you would have to support for your motion to set aside, assuming all that to be true and assuming all of that not having been known by the Court, is that if (21) the Court had known that these witnesses had those agreements for compensation, the Court would have disbelieved those witnesses and reached a contrary conclusion.

MR. BENDER: That's correct, your Honor, because your Honor has cited the testimony of some of those witnesses in his opinion.

THE COURT: But that is the burden that you have.

MR. BENDER: That's correct. Not only that, your Honor—

THE COURT: If the Court had known that the witnesses were—

MR. BENDER: Had their attorneys' fees being paid—

THE COURT: —that their attorneys' fees were being paid for by SFREI—

MR. BENDER: Right.

THE COURT: that the Court would have taken into consideration in evaluating the credibility of the witnesses and would have reached a contrary conclusion.

MR. BENDER: That is correct.

THE COURT: But none of that has anything to do with the appraisal.

MR. BENDER: Yes, it does, your Honor. (22) Your Honor is jumping to that conclusion. I submit to you that it doesn't follow.

THE COURT: Because?

MR. BENDER: Because, number one, the witnesses themselves were testifying about valuation and what happened when they received the valuations. The entire testimony of those witnesses was critical on the issue of valuation and how they responded. In fact, your Honor spent a good portion of your time in your opinion about that.

And, furthermore, if your Honor please, on also the credibility of Mr. Chappell, on Mr. Chappell's credibility and on the credibility of the people that San Francisco produced, whom you never heard, your Honor, but we had deposition testimony, and on how that testimony would be viewed if San Francisco had seen fit to pay money to the lawyers for the former trustees in order for those lawyers to prepare the witnesses to testify.

And we submit, your Honor, if that were brought out, as we think it has been already established initially, and we think that further discovery in that area will further enhance our position along those lines, that then your Honor is going to look at the matter through different eyes, in the sense that you are now looking at the matter that these witnesses have in effect had (23) their attorneys' fees paid and that this arrangement was kept secret from your Honor. For what purpose, your Honor? If it was an aboveboard agreement, it would have been called to your Honor's attention and gone to the weight of the testimony.

But here they didn't even do that. In fact, Mr. Kraus says, "Well, they are too late in bringing this."

In other words, up until now they have been successful in concealing it from the Court and from us and therefore, of course, we are late because we did not come forward and say "Judge, this is our arrangement that we made with Williams & Connolly and with Mr. Welte in terms of the payment of the attorneys' fees of the former trustees."

Now, if they had brought that out, your Honor, that would have permitted us to make an argument to your Honor in terms of

fair value. But as a result of procedure that your Honor adopted, we were never able to brief the question of fair value because, as your Honor may recall, on the last day that Mr. Farber testified, your Honor cut of all further briefing and we never did get to your Honor in an organized fashion. We couldn't very well brief what a witness is going to say, and we therefore had no brief filed on Mr. Farber's testimony—

(24) THE COURT: You know—

MR. BENDER: Your Honor, that is the facts.

THE COURT: Your language is current with respect to world events and politics, but are you saying that there were surprises at the trial, that there were issues that you didn't anticipate?

MR. BENDER: No, your Honor.

THE COURT: That you didn't have a full opportunity to explore any of the valuations questions?

MR. BENDER: What I'm saying to your Honor is that normally, after a trial, on a critical issue of valuation, when you have a witness like Mr. Farber on the stand, that to pull together all of the evidence which demonstrated the unfairness of the value—there were such things here that we believe your Honor overlooked in terms of fairness, and there was—

THE COURT: But what you can't accept is that it is over, that you've had the trial, you've put your best shot forward, you very diligently represented your client, and you've lost.

Well, that happens to litigators, and they go on. They go on to the higher floors of this building—

MR. BENDER: I recognize that your Honor.

THE COURT: Or they go on to other matters, but they don't stay constantly before the district court.

(25) MR. BENDER: Is your Honor suggesting a motion under Rule 60(b) or anything prior to that is nonsense before it is even made?

THE COURT: No. What I am suggesting is that if you really have a perception of what occurred so that you in good faith say you didn't have the full opportunity to brief the fair value issues in this case, then I have to say, in all respect, that you've lost perception to such an extent that I really feel that your usually effective advocacy is failing.

MR. BENDER: Your Honor, may I say this? Even if you disagree with that , I will say this to you: that things came out on Farber's testimony that your Honor I believe has not previously had an opportunity to take into consideration, because the issues, and your Honor's rulings in connection with them, first came up at trial and were not anticipated, namely the production of certain documents which Mr. Farber had in his file which came from San Francisco and which San Francisco never previously produced.

But, your Honor, let me concentrate on the big thing, which is the testimony of the seven so-called Gramlich people—

THE COURT: Yes.

MR. BENDER: —who had their attorneys' (26) fees paid by San Francisco, our adversary.

Your Honor, there is a law against that in the land, which law has not previously been called to your Honor's attention.

THE COURT: Which law is not before me.

MR. BENDER: It is, your Honor.

THE COURT: Let me say this, very clearly. If you believe that there is a matter here which should be called to the attention of the United States Attorney's Office, it is your obligation to do so.

MR. BENDER: I will do so.

THE COURT: If you believe there is a matter which should be called to the attention of the Grievance Committee, it is your obligation to do so. But that's not what you are arguing now.

MR. BENDER: That's correct.

THE COURT: What you are arguing now is discovery in support of a contemplated motion to set aside the Court's findings of fact based on material which you say is now known and was not previously known.

MR. BENDER: That's correct.

Now, let me say this to your Honor: What your Honor says in terms of my duty and also your Honor's duty to a Grievance Committee here is to go to the United States Attorney's Office and to go to a Grievance Committee.

(27) Correct, your Honor. And that is penal in nature, and that does not give me relief from your Honor in this case, and that's what I'm seeking here and now.

And I have demonstrated, through the admissions of Skadden, Arps, of Williams & Connolly, and the Welte firm, that indeed there was a violation of Section 201(c) (2). We don't have to show intent to influence witnesses or anything.

Now, given that posture of our showing, and we have shown that just on the papers that have been submitted, and if your Honor denies this discovery I am prepared to make a motion, just based on what has been shown up until now, I think we would be able to enhance our motion if we had discovery as we want—

THE COURT: What further motions are you contemplating in this case?

MR. BENDER: I am now prepared, if your Honor denies my discovery motion, to make a motion, which I have a duty to do to my client and to the Court—

THE COURT: Yes.

MR. BENDER: I am now prepared to make a motion to set aside the verdict on the grounds that these witnesses have in effect been corrupted under that statute, that there has been a violation of that statute, (28) and therefore that the verdict should be set aside because, if your Honor upon viewing this evidence—

THE COURT: Make your motion. I'll accept it as an oral motion. Make your motion.

MR. BENDER: I would like time to make it and show the impact on this. We certainly can show that J. Russell Gramlich, which your Honor has relied upon—

THE COURT: What is there that is not in these papers now which would be in your motion?

MR. BENDER: Your Honor, I will go through it and I will show you the impact on the witness' testimony.

THE COURT: Proceed.

MR. BENDER: Your Honor, I am not prepared to do that now.

THE COURT: Oh, you are not?

MR. BENDER: I would like some time to do that.

THE COURT: How much time would you like for that?

MR. BENDER: In order to examine the record carefully, your Honor, I would need thirty days.

THE COURT: There is a judgment that has to be entered, and—

MR. BENDER: Well, your Honor—go ahead, (29) your Honor.

THE COURT: And what do you anticipate happening in the thirty days for you to make your motion?

MR. BENDER: I would like your Honor to withhold the entry of judgment.

Your Honor, it has been a year since the trial. And after all, the purpose of litigation in the district court and of Rule 54, your Honor, is to have all matters disposed of in an orderly fashion. And certainly, to give counsel time to make a motion where we have made a prima facie showing, where we have shown, based on the admissions and the responses of the defendants, that indeed there was a violation of 201(c) (2), I believe it would be unfair for your Honor to say go ahead and make your oral motion now.

But if your Honor gives me thirty days—

THE COURT: Thirty days?

MR. BENDER: Yes, your Honor.

THE COURT: Asking for thirty days makes it very easy. I mean, certainly I am not going to hold this in abeyance another thirty days for you to make a motion predicated on what is already before the Court.

MR. BENDER: Your Honor imposes a time limit?

THE COURT: I will.

(30) Have you finished now on this aspect of your motion?

MR. BENDER: Yes, your Honor.

THE COURT: I'll hear from Mr. Kraus.

MR. KRAUS: Your Honor, there aren't any adjectives in the English language that I can summon up to characterize this performance. There is absolutely no basis in law or in fact for any of these charges that have been made or for seeking additional discovery.

And I just want to point out right now that this request for additional time is outrageous because, if you entered a final judgment today and you accept all his arguments about Rule 59 and Rule 60 not being applicable until you enter a final judgment, he only has ten days to move for a new trial. That's the most time he has, under the rules.

He sat here during the proceedings and he listened to all this testimony. He made this motion three weeks ago. How does he have the nerve to get up here and tell the Court that he is not familiar with the record and that he needs more time to go through and marshal his evidence? This is outrageous. This is a sham.

The Court is being imposed upon here. It is very clear, simply by reference to the statutory sections (31) and the Code provisions that he is relying on, that he doesn't have any claims here.

And I just want to go through it very briefly, and I apologize because it is burdensome or repetitive. They are principally relying on subsection (c) (2) of 18 U.S.C. 201. That section prohibits the giving or the promising of anything of value to a witness for or because of the testimony of the witness.

Now, this is the classic bribe situation: I give you a hundred dollars and you say the light is green, or red, or whatever the interest is.

He says there is no need to show intent. That's right. But he is totally ignoring the requirement that he has to show that the payment was for or on behalf of the testimony. And he hasn't shown that here and he can't show it here because in order to make that kind of a showing he has to show a linkage between the alleged payment and the testimony.

And these witnesses all sat here and they said they had no idea who was paying the fees; they just knew that they weren't paying the fees. They didn't know that there had been any agreement.

When he stands there and tells your Honor that they all assumed that Gramlich would pay, that is false. There was no such testimony. We attached the (32) testimony as Exhibits A through G to my affidavit. That's a false representation to your Honor that he is making about what was said here.

And, furthermore, no one testified falsely in this case. All these people said was: "I don't intend to pay the fees and I don't

know who is paying the fees." And there isn't anything that shows that that was false.

So there isn't any violation of subsection (c) (2). These people were totally unaware of the payment and there weren't any conditions on the payment; it wasn't a payment that, if the testimony comes out right, then you'll get your fees. So there can't be any linkage here.

Now, subsection (b) (3), on which they also rely, is equally inapplicable. That provision prohibits a gift or a promise of something of value—

THE COURT: You are dealing with the penal aspects of it, which are not really before me.

MR. KRAUS: I completely agree with that. I've never been accused of bribery before and it is a shocking allegation, and I want to respond on the merits because this impugns my reputation and the reputation of others in my firm, and it is just outrageous. I'm sorry, but I can't think of any better way to characterize (33) it.

I mean, subsection (b) (3) of 18 U.S.C. 201 refers to payments that are made corruptly with intent to influence the testimony of a witness. This section is intended to cover the situation where, you know, you don't have a bribe, I don't say "Here's a hundred dollars. You say the light is green." I just take you out to dinner and take you to Europe and your wife gets a gold watch or a pin or something, and then I say "I am doing this because I'm your friend and I hope the testimony comes out right." So it is a case where you can't show the linkage.

That section is obviously inapplicable here because we had no contact with any of these witnesses. We never spoke to these witnesses except for cross-examining them in front of your Honor and the times when they were deposed when we asked them questions at their deposition.

All we did here, we ought to keep this in some kind of perspective, was to agree to pay the reasonable fees, the customary

charges of the lawyers for these witnesses. There weren't any trips on fancy yachts or trips to Europe or anything like that. We didn't have any contact with the witnesses.

I mean, if you were intending to corruptly (34) influence somebody's testimony, that is not the way to go about it.

The fact is also that there is absolutely nothing in any rule anywhere that prohibits the payment that we made. And Mr. Bender has cited, twice now in his opening brief and in his reply brief, the Marchese and the Lichtenstein cases for the principle that you can't pay the fees of another party's lawyers. And that is just totally false. Those cases have nothing to do with that issue. He obviously hasn't even read the cases.

The Marchese case involved a question of whether, under 28 U.S.C. 1821, the Federal Witness Statute, a witness could collect from the government the fees of his lawyers when he brings them along because he has been subpoenaed to testify as a witness. And the Court says no, that's not one of the compensable items under the Federal Witness Statute.

And the Lichtenstein case holds, on the facts of that case, that the plaintiff was not entitled, under the Court's equity power, to recover attorneys' fees against the defendant because the defendant hadn't engaged in vexatious or bad faith litigation.

So neither case says that when you pay another party's lawyer's fees that that's improper. (35) Frankly, we think it is highly doubtful whether there was any payment here within the meaning of the statute, direct or indirect, to any witness, because all we did was to pay the fees to the witnesses' lawyers. The witnesses didn't end up with any profit here. They didn't even know that we had agreed to make the payment.

And they can't point to any case that says there is anything wrong with that. And they make the amusing argument at page 10 of their reply brief, in response to our argument that they can't point to any case that says it is improper, that we can't point to any case that says it is.

Now, it is now our burden. This is a Kafkaesque kind of argument here. It is bizarre.

The fact is actually that the Code does contemplate the payment of a lawyer's fee by someone other than the lawyer's client. So there is something in the Code that does contemplate that situation.

Now, with respect to the specific Code provisions that he is relying on, first it points to disciplinary Rule 7109(c). That rule proscribes contingent payments, and I don't understand him to be claiming that there was a contingency. He argues in his reply brief that it was a deal. And there wasn't any contingency, regardless of what he argues.

(36) Moreover, subsection (1) of that disciplinary rule expressly permits the payment of a witness' reasonable expenses in attending or testifying. Expenses in attending encompass probably air fare and those kinds of expenses, and expenses in testifying can include the witness' lawyer's fees. There isn't any provision that says that that's not a compensable expense. And, as we point out in our brief on page 19, disciplinary rule 5107(a) expressly contemplates there are circumstances under which that is proper.

The ethical consideration that they are arguing here, DC7-28, simply says witnesses should testify truthfully and should be free from financial inducements to testify otherwise. They were, and they did testify truthfully, and the witnesses didn't know of any arrangement to pay their lawyers' fees by us, and so they couldn't have been induced to testify otherwise.

And I think it is very significant that your Honor asked the question what would be different in the witness' testimony and he starts talking about Mr. Farber's testimony. I mean, that's ironic, because Mr. Farber, you will recall, was the expert who used to work for us and then he violated his own real estate code of ethics to take pay from Mr. Bender to testify on his behalf. We had a disqualification motion on (37) that branch.

But the fact is the witnesses testified perfectly truthfully here. He doesn't point to any part of their testimony which would be different or in which they supposedly didn't tell the truth.

And, you know, he took all of their depositions, and the testimony at the trial was completely consistent with their deposition testimony, and we weren't paying their fees when that happened. And their testimony at trial was completely consistent with all the other facts here.

So, you know, what is this all about? This is a motion to reverse the judgment and find for him not because the facts have changed in any respect but because he doesn't like the fact that we paid Mr. Welte's legal fees.

On top of all this, he accuses us of violating DC7-102(a) 3-6 or 3, 4, and 6 by not disclosing that the TRT trustees were testifying falsely.

They weren't testifying falsely. All they said was "We don't know who is paying our fees. We know we are not paying our fees."

The notion that these witnesses are testifying falsely is just an assertion that is being made here. There isn't any basis for that. But I think the critical (38) point is that, if Mr. Bender wanted to know who was paying their fees, Mr. Umin and Mr. Welte sat back there for days while all these people were being examined by Mr. Bender, and he asked every one of them, "Who is paying Mr. Welte's fees?" Remember how he pointed to Mr. Welte? He could have called Mr. Welte to the stand when they didn't know who was paying. Ask Welte, ask Umin. They are sitting right here.

So this is another circumstance where there is obvious neglect or whatever. Maybe he was saving it up to use it now, but for whatever reason he sits here with the evidence right in front of him and doesn't call the people to the stand now, when the gavel is about to come down and we are finally about to ring down the

curtain on this long running act, he says, "Oh wait. I would like to reopen discovery here." This is absurd.

And there wasn't any concealment of anything. He can't point to any provision of law or any provision in the Code that creates some duty in us to stand up and say, "The witnesses don't know what the arrangement is, but let me tell you what the arrangement is."

And the disciplinary rule that he points to refers to representation of a client within the bounds of the law. These people were not my clients, and when (39) they said they didn't know what the arrangement is, it doesn't lie in me to stand up here and say they are lying.

They weren't lying. They were telling the truth. And it particularly isn't up to me when the people who know are right here and can be called by Mr. Bender any time.

So there just isn't any proposition, any support here for this motion that anything was concealed from the Court.

Now, again, the Court really has to ask: What is the point of all this? He says he wants to vacate the judgment and have a new trial. But he hasn't attacked the veracity of anything that any of the witnesses said with respect to the merits of the case. They all testified at length. They were thoroughly cross-examined by Mr. Bender in excruciating detail. Their testimony was entirely consistent with the prior testimony they gave and with the other facts of the case. So there isn't any basis for a new trial here.

The simple truth is that he tried the case and he lost and now he would like to try the lawyers. And he attacked the witnesses and he failed and now he would like to attack the lawyers.

There just isn't any basis here for allowing him to do this and to prolong this thing with more discovery. (40) It is just another maneuver to delay the entry of final judgment.

And he admits even, in the letter that he sent, your Honor, that there is nothing new here. He knew all these facts, obviously,

at the close of trial. So why is he saying it now? Obviously the reason is delay.

Now, we have been at this for almost seven years now. He has told the Court over and over that there was $25 million given away here, and that is nonsense. And now he faces a big judgment for attorneys' fees. It is no wonder he wants delay.

THE COURT: There is a third motion, which is your motion?

MR. KRAUS: Yes.

MR. BENDER: May I be heard in response to him?

THE COURT: No.

MR. BENDER: If your Honor please, there have been statements made that are just not true, and I think I should, as a matter—

THE COURT: Just state what those statements are that are untrue.

MR. BENDER: He said there was no statement made in the testimony that was untruthful.

(41) In fact, Gramlich testified that "I will try to work something out with San Francisco to see if they will kick in some money." And this was told to him by Welte. If Welte in fact told him that, which we believe he did, then under the circumstances Welte had already had an agreement with Mr. Kraus that San Francisco—

THE COURT: He is saying the witnesses didn't know, that the testimony given by witnesses was not known to be untruthful, they weren't sitting here while the witnesses perjured themselves.

MR. BENDER: Your Honor, that is suborning perjury, your Honor. If a lawyer tells a witness to say something and the lawyer knows that something is contrary to fact, that is suborning perjury by the lawyer, if your Honor please. And the whole purpose—

THE COURT: They were paid by someone else.

MR. BENDER: Yes, your Honor. and he says that the Code contemplates that someone else is going to pay the fees of the lawyer. That's just not true, your Honor.

Thirdly, your Honor, your Honor makes the point that this is a penal statute. I hope your Honor is not suggesting that this penal statute is not applicable to this civil litigation merely because—

(42) THE COURT: Oh, it is certainly not difficult to hypothesize a situation in which there is conduct with respect to a witness which may be unlawful, a clear out-and-out bribe.

MR. BENDER: Like a bribe given to him directly?

THE COURT: Yes. And the Court may still be of the view that the credibility of the bribed witness was not material to the outcome of the litigation. I am just saying that the issues that are presented when an application is made for discovery to support a motion for a new trial are very different issues from the issues raised with respect to whether or not there has been a violation of the penal statute.

MR. BENDER: With respect to that, your Honor—

THE COURT: I gave you leave to address the Court solely to point out those aspects of Mr. Kraus' remarks that were untruthful.

MR. BENDER: He said there was not a profit to any of these witnesses. Mr. Welte told Mr. Gramlich that if San Francisco didn't kick in, he would be responsible. That meant that Mr. Gramlich would be responsible for $50,000 in attorneys' fees. That was certainly profit, your Honor.

(43) Now we are also dealing with what was so-called innocent arrangements.

THE COURT: I think you've—

MR. BENDER: Let me say this, your Honor—

THE COURT: No. Would you please be seated? Thank you.

* * * * * *

(50) MR. KRAUS: Your Honor, the point is what we are asking for—he keeps calling it the prejudgment interest. It is post-judgment interest.

MR. BENDER: There is no judgment. How can there be post-judgment interest?

MR. KRAUS: There is a judgment, from October 24th.

MR. BENDER: No, there is not, your Honor. What they are asking for is attorneys' fees and also, in their supplemental fee request, attorneys' fees on the three motions that we have made, and we submit, your Honor, that these motions were made in good faith, they are based on the misconduct of the defendants and their counsel, and under those circumstances we believe them to be well grounded motions and we believe that they should be decided affirmatively.

In other words, he is asking for attorneys' fees to defeat our motion for sanctions under Rule 11, and I think that is just chutzpah, if your Honor please, (51) under the circumstances.

THE COURT: Well, you know, the legislative debate and the legislative history with respect to Rule 11 raise as a horrible events which history has shown to be the case, and that is Rule 11 motions being brought to obtain sanctions for the frivolous attempt to collect Rule 11 sanctions. The spiral can go on forever.

The following constitutes the determination of the Court with respect to the outstanding motions:

First, with respect to the motion by Terrydale Liquidating Trust for Rule 11 sanctions with respect to the assertion of jurisdictional defenses by SFREI which the Court determined to be "devoid of merit," that motion is denied, and as I indicated in my

colloquy with counsel, I considered sua sponte, when this issue was previously raised, what sanctions would be appropriate in the total context of this litigation, and nothing has been called to my attention which convinces me that the sanction that I adopted, which was to deny SFREI's its application for attorneys' fees for time expended in connection with that application, was incorrect.

I have previously denied Terrydale's contention that the conduct of SFREI in connection with the jurisdictional matters was so egregious as to warrant a withholding of an award of attorneys' fees to SFREI (52) pursuant to the contract reimbursement provision.

What is before me now is a further gilding of the lily on this litigation in which both sides seek to move to imaginatively seek ways of escalating the amounts in controversy and the issues in controversy, so that the litigation seems endless.

Turning then to the application of Terrydale to open discovery in support of a motion which it might eventually make to set aside the Court's findings of fact predicated on the arrangements which were made for the reimbursement of witnesses, that application is denied.

I consider the issue as a discovery motion in support of a contemplated motion to set aside a fact-finding in a civil case. That is all that is before me. Matters which might be of concern to the United States Attorney or to the Grievance Committee are not now before me.

The motion is denied on several grounds, the principal ones being that, assuming the truth of the allegations, the Court does not perceive how it could have impacted on the ultimate determination on the merits which the Court made in this case tried to the bench.

The relationship of the witnesses to the parties, where their sympathies lie, where they perceive their self-interest to lie, was quite apparent during (53) the course of the trial to the Court. It certainly should have been quite apparent to Mr. Bender. And if

he had thought that that matter was worth pursuing further at the trial, he had the opportunity to do so.

I believe it is appropriate for me to deal not only with the motions that have been made but with a motion which has not been made, and that is the request by counsel for Terrydale Liquidating Trust, if the Court denies its discovery motion, that it be allowed a period of thirty days in which to make a motion to set aside the Court's findings of fact predicated on the same issues and contentions which would be the subject matter of the discovery which counsel for Terrydale seeks.

There must be an end to this matter, and the Court has regretfully reached the conclusion that the desire for delay, plus other emotional aspects which have entered into this case, are motivating such an application.

The Court does not lightly deny any application to make a motion, but counsel for Terrydale has declined the opportunity to make that motion orally, nor has counsel for Terrydale suggested any more reasonable period of time for the making of such motion.

I am not going to delay the entry of any pending order or judgment in contemplation of the making (54) of any such motions.

MR. BENDER: Given that situation—

* * *

(55) THE COURT: . . . I will ask counsel for SFREI to submit to me, with all the arithmetic done, no later than 11:00 a.m. tomorrow a final judgment which I will execute.

* * * * * *

(57) MR. BENDER: Your Honor please, if your Honor is not going to afford me an opportunity to make a written motion, I would like to make some comments, if your Honor would still

bear with me to make some comments, as to the impact that I think the payment of legal fees had on the testimony of certain witnesses and what that meant in terms of the outcome of the case.

THE COURT: Are you saying you wish to make an oral motion now?

MR. BENDER: In light of your Honor's denial of my request to make a written motion.

THE COURT: But this is now your motion. This is your motion.

MR. BENDER: This is my motion.

THE COURT: To be treated as your motion for a new trial?

MR. BENDER: Yes.

* * *

(64) THE COURT: . . . All right. Mr. Bender, you want to be heard on your oral motion to set aside the Court's findings of fact and conclusions of law?

MR. BENDER: Is your Honor going to give me an opportunity to examine the numbers that Skadden, Arps submits to your Honor before your Honor signs the document?

THE COURT: When can you hand deliver it to Mr. Bender?

MR. KRAUS: I think I can give you the numbers right now, or if you want to take a five-minute (65) recess, I can give you the interest figures.

THE COURT: I will tell you what I will do. Let me hear Mr. Bender on his motion. I have another matter. I will then hear that other matter.

While I am hearing the other matter, suppose you do the arithmetic, if you can, and show it to Mr. Bender and then submit it to me, and we will sign it this evening rather than tomorrow.

MR. KRAUS: Terrific.

THE COURT: Mr. Bender. Tell me how long you want, for the benefit of counsel who have been waiting now.

MR. BENDER: Your Honor, I have no idea, I really am doing this extemporaneously, and I am doing it because your Honor has denied my motion.

THE COURT: Let me hear my other motion. You do this. Make your first order of priority the finalization of the judgment and then you can collect your thoughts on the motion and let me hear Contemporary Communications.

MR. KRAUS: Your Honor, do you have the form of final judgment?

THE COURT: I have the final judgment. I have something which is headed "Final Judgment August 18, 1987."

(66) MR. KRAUS: I think that's what we submitted. I just want to make sure we are working from the same form.

* * * * * *

THE COURT: I'll put this matter down (67) for 9:00 a.m. tomorrow, Mr. Court Reporter, when we will deal with the final judgment.

We will also deal with your motion for a new trial and any other applications you make. 9:00 a.m. tomorrow morning, promptly please, in this courtroom.

* * * * * *

(An adjournment was taken to Friday, August 28, 1987, at 9:00 a.m.)

(68) August 28, 1987,
9 a.m.

(Hearing resumed)

THE COURT: Good morning.

We have three matters on our agenda. One is Mr. Bender's oral motion for a new trial.

The second is the final judgment.

* * *

THE COURT: . . . Mr. Bender having had overnight to think about the matter, how long do you wish for your oral motion?

MR. BENDER: I would like to have a half hour, your Honor.

THE COURT: Very well. You may proceed.

MR. BENDER: Your Honor, the motion is to set aside the judgment and, as your Honor may see fit, to order perhaps a limited retrial with certain testimony that has already been taken before your Honor to be deemed submitted (69) subject to bringing out new facts in evidence rather than an entire new trial.

I would like to state the reasons why. In light of things that have come to light, namely, what we consider to be the violation of 201 (c) (2), the payment directly or indirectly of the legal fees of the former trustees who were witnesses at the trial. In that connection, the payment to their attorneys we consider an indirect payment to the witnesses themselves.

I would like to first start in terms of the impact of the premise that San Francisco has done an illegal act under 201 (c) (2) based on the present facts before your Honor. In that connection, I allude to page 7 of your Honor's opinion in which there is reference made to the testimony of J. Russell Gramlich, and that the payments on the note could have been met by turning the Gramlich stock over to BCG at the last moment if they had no better offer for our stockholders.

Mr. Gramlich testified to that not from memory as to what took place in 1981, but what someone told him approximately two weeks before, so he said, He testified after a weekend.

I would submit, as your Honor's opinion points out, there are certain difficulties regarding this testimony. Number one, John Gramlich himself had not even (70) mentioned such a plan in his testimony. Michael Gramlich had not mentioned such a plan in his testimony. Here was J. Russell Gramlich coming up with a plan which he admitted had not been disclosed to him back in 1981, and which he was asking this court to believe was in fact in place in 1981, even though he had no knowledge of that plan in 1981.

Considering the fact there was a payment of legal fees to J. Russell Gramlich's personal attorney and his former trustee attorney, we think that that tips the scales, if your Honor please, and that as a result of that, in looking at J. Russell Gramlich's testimony, which was indeed doubtful to your Honor even at that time, should tip the scales even further, because—

THE COURT: I placed very little weight on the testimony of Mr. Gramlich Sr. This was a valuation case. The factor which led to the denial of the motion for summary judgment, and the gist of this case, was whether the values of the real estate were so grossly understated as to make the conduct actionable.

The key witness in this case was the real estate expert, Mr. Farber.

MR. BENDER: I believe the opinion goes off on the question of whether or not, notwithstanding that value is a very important issue in the case, but your Honor's opinion discusses the question of the self-interest of the (71) Gramlichs, it discusses the issue of whether or not the Gramlichs controlled and dominated the other trustees, because if indeed, as your Honor's opinion points out, if there was control and domination of the other trustees then under the circumstances the entire transaction would be set aside because it couldn't be a valid transfer.

Therefore, domination and control, and the credibility of all of the trustees, was certainly important in that issue, your Honor, as I read your Honor's opinion.

In this same connection, the self-interest of the Gramlichs, and whether the Gramlichs were indeed in severe financial straits, was a very important issue, and this is what J. Russell Gramlich was testifying at this time.

The question is where would Mr. Gramlich's stock holdings have left him under the circumstances if they had been locked in, and if the Terrydale tender offer had been successful.

We submit under the circumstances, given the whole posture of the matter, his testimony as to what would have happened, what were his alternative plans, were completely contrary to what Michael and John Gramlich testified to, because John Gramlich said, well, I would go out and I would borrow money from a friend.

Michael Gramlich said he really didn't know what (72) he would do.

So basically J. Russell when he came up with the testimony he did, came up with what was indeed inconsistent with everything that had been said up to that point, and I point out to your Honor this occurred after a weekend, and as to what preparation J. Russell had over the weekend indeed would be significant, in our view, because, after all, when San Francisco paid Williams and Connelly and Welte—we have to be realistic, your Honor, Williams and Connelly understood what was in the best interests of San Francisco. They understood that.

I would just like to continue with this, your Honor, and I would like to call your Honor's attention to footnote 2 and footnote 4 of your Honor's opinion, both of which go off on the question of the credibility of the former trustees.

You found credible, your Honor, the independent trustee's testimony with respect to the so-called independent meeting—meeting of the independent trustees.

One of the important factors there was Mr. Polsinelli's presence, which I submit to your Honor was really the alter ego of the Gramlichs, as your Honor has identified.

The question is how much weight was Mr. Polsinelli's presence, and what was the impact of it?

(73) I submit to your Honor that Mr. Polsinelli had testified at deposition, and Mr. Polsinelli's firm was one of the law firms that received attorneys' fees from San Francisco ultimately before the trial—not before the trial, after the trial, after your Honor's decision came out.

Your Honor's decision came out August 26. August 27 San Francisco sent a check to Polsinelli's firm.

Again, the issue of how this impacts on the credibility of Mr. Murphy, Mr. Stamper, Mr. Polsinelli, and Mr. O'Flaherty, it seems to me is directly in point of how you would now view that testimony given these payments by San Francisco, and the fact that San Francisco had previously deceived the court in terms of its jurisdiction by the false affidavit of Chappell and by Mann's false affidavit, false affidavit in the sense that Mann only referred to his telephone conversation in New York when we know much more took place.

In terms of footnote 6, your Honor alludes to the fact that if the independent trustees were not so dominated and controlled—and of course if they were dominated and controlled, as I said before to your Honor that would then have meant the entire transaction would have to be set aside because it was in violation of the declaration of trust, and your Honor pointed this out in (74) your opinion on the summary judgment issue.

Secondly, I would like to call your Honor's attention to the fact there was no dispute to the fact that San Francisco had read the declaration of trust beforehand, knew the provisions of the declaration of trust, so this was something not unknown to them.

Of course, what we are really dealing with is the whole realm of fair inferences from testimony and what can be fairly read into the testimony based on credibility, and factors like that.

It is in this vein that I submit to you that I believe the payment by San Francisco to the former trustee's attorneys has an impact.

I would like to then go on to the fact that not only on page 7 does your Honor develop that point, but also I would like to point out that on page 8 your Honor goes into it in terms of Stamper's testimony.

There you are judging the question of Mr. Stamper, and the fact that he was taking a position that he had no self-interest when his firm got in that particular fiscal year something like $250,000 in legal fees in contrast to $50,000 in legal fees the previous fiscal year.

Then you get into Mr. Murphy's testimony, and Mr. Murphy's testimony was, sure he had a conversation with Blaine Chase and asked Blaine Chase to render a revaluation (75) on the Lincoln Tower building.

Mr.Murphy testified that he didn't advise any of the other trustees about that when the valuation of Blaine Chase came back to him, which was an increase in value of 75 percent cashwise. In other words, their equity would have gone up from 8 to 14 million, and that 6 million dollar difference represented over $10 a share.

When you consider the fact that here is a very significant revaluation, which by all the rules of the SEC should have been disclosed to the shareholders, should have been disclosed to all parties, to everyone of interest, it would be hard to say under those circumstances that, first of all, TLT—not TLT, but the Bolton plaintiffs could not have gotten an injunction if there will be a disclosure of that upward revaluation.

One of the factors in the Greene case, that part of it in 1976 not overturned by the Supreme Court in its holding of fraud, was the fact that there was a forced sale, and here we have the same thing.

This was a forced buyout of the shareholders. They did not give the stockholders an opportunity to make a choice. They said we are liquidating, and in a liquidation that was a forced sale.

There are all kinds of problems associated with that transaction from the standpoint of J. Russell Gramlich, (76) and your Honor lists them in here.

Another one is the fact that J. Russell Gramlich had previously advised the shareholders that they were not going to sell share their shares.

The SEC would not permit a controlling stockholder given that scenario at the last moment to throw in his shares and tender them after telling the stockholders he and his family were not tendering.

Getting into the revaluation again, and Mr. Murphy's testimony about that revaluation, it is the testimony of all the other trustees that Mr. Murphy did not tell them anything about that revaluation.

Your Honor, it is incredible to me, that here is a so-called independent trustee who is not communicating to any one of those other trustees what he has learned which substantially increased the contractual value of the Lincoln Tower property by over $10 a share.

In addition to that, you have the fact that the Gramlichs had admitted to a third party that the valuation on 101 University was four million dollars right at the end of January 1981, even though they sold it for $2,450,000, or $2,800,000, something like that, a one million dollar difference. Equitywise, of course that is more important.

The same factors that drove up the price of the (77) Lincoln Tower building were also attributable to the Petroleum building, because it was the same kind of building, it was a class B building, it was directly opposite—it was on the main thoroughfare, and it was considered in the same zone, even by Mr. Bowes.

Accordingly, here was the Petroleum building, which San Francisco itself valued in December of 1981 at $12.4 million, and they had sold it for $6.7 million. Again, your Honor, almost a $10 difference per share.

These were the same factors involved. This was not something that was not known to San Francisco, because San Francisco immediately—and these were objective criteria, your Honor—San Francisco immediately, when in February of 1981, it took over Petroleum—was able to increase the rents, which had no relationship whatsoever to the appraised value. They went from something like $10, which the appraiser had used, to something like $13.75 per square foot.

Those factors, your Honor, plus the capitalization rate—and Mr. Farber was the independent appraiser chosen by the Chase Manhattan Bank and by the seller to value the Lincoln Center building in October of 1980.

So this man was not coming to your Honor without credentials. Here was a person who had been chosen by the (78) seller and the buyer because of his competence in this area, and he had valued that Lincoln Center building and came in with a cap rate of 6.5 or 6.6, something like that, your Honor.

Given that factor, given the objective evidence of the valuation by San Francisco in December of 1981 of the Petroleum building, and their objective valuation of the 101 University building in December of 1981, when they valued it at $4.8 million, with improvements—and we have adjusted that to come down to a value of $3.8 million.

Given those factors, your Honor, when you add all the numbers up of the Petroleum building, the Lincoln Tower building—and I must point out to your Honor on Lincoln Tower Building as your Honor recites in your opinion the property was sold for 26 million dollars in September of 1982, but what your Honor doesn't say anything about, with all due respect, is the fact here was a property that had been sold after Mr. Bowes described it in a

crash condition in the Denver market yet brought in 26 million dollars, so that the conditions were far less advantageous at the time of transaction than in February of 1981, yet it sold for 26 million dollars.

Mr. Farber valued it at 24 million dollars, which was approximately 2 million dollars over Blaine Chase's net valuation, I believe your Honor.

(79) I submit under the circumstances Blaine Chase had no ax to grind when he made his valuation in February 1981. That was a key objective appraisal, and the fact these trustees came here and testified that they didn't know about that, how can one say that the duty of a trustee has been fulfilled under those circumstances?

They have not fulfilled their obligations if Mr. Murphy didn't even tell the other trustees, taking the testimony as it is. But certainly the probability is that there was disclosure to these trustees. It is very doubtful, your Honor, that a person like Mr. Murphy, who Mr. O'Flaherty was relying heavily upon and who was a so-called independent trustee, would under those circumstances remain silent and not disclose a very important number to the other trustees.

As far as self-interest of the Gramlichs is concerned, your Honor, there is one very important thing.

Before I leave the question of valuation, your Honor, as of February 1981 the document in evidence from San Francisco's new broker for February of 1981 showed a rental rate of $14.62 per square foot.

The appraiser in June of 1980, when the building was occupied, showed $10 per square foot. That was a very significant difference in terms of valuation. Plus the fact as of February 1981 this building was in prime (80) condition, because it was unoccupied totally. That meant it was better in terms of its condition for the marketplace.

When you take the rental rates, and you compare what the appraisers used — those appraisals were obsolete, your Honor, as of February 1981, and the defendants didn't submit any appraisal as of February of 1981, to demonstrate the value. There was not a appraiser by Mr. Bowes. He was called in to testify as to what —

THE COURT: You realize, Mr. Bender, that you are arguing the merits of the case. You are making arguments which you made very forcefully during the course of the trial, and —

MR. BENDER: Your Honor said that was the key point, which is why I went off on it. I think that has an impact because we are dealing with the duty of trustees and whether they acted reasonably.

First of all, as to whether or not there was a conflict of interest position, and whether they were dominated and controlled by the Gramlichs, that's number one.

If they were dominated and controlled by the Gramlichs, naturally, their duty of loyalty would cast the burden of proving fair value on the defendants, and they have not shown fair value by any kind of evidence under those circumstances.

(81) Given the posture of the testimony of the trustees, and what they were hoping they could accomplish in terms of this transaction, your Honor says they acted with due care, and I submit to your Honor that under all the authorities where they do not get an opinion from a financial house as to what their alternatives were, that that by itself shows that they were not acting with due care. They were in a rush to sell. This was a fire sale. They sold without regard to the current real value.

Their deliberations could hardly be called prudent business valuation considerations when Murphy, on his testimony, didn't even tell the other trustees that these other properties were of higher value.

Then we get into the question of the self-interest of the Gramlichs. On the self-interest of the Gramlichs, there was a document in evidence — first of all, there was commissions to the Gramlichs of $312,000 after the transaction went through, and the question is at what point does a person have a conflict of interest in terms of trying to feed his own pocketbook.

Basically, we have that the underlying the agreement that John Gramlich met, arranged, with San Francisco in California, Mr. Chappell, showed that $350,000 was going to be paid by San Francisco to Terrydale Management Corporation for fighting off the unfriendly (82) tender offer. That $350,000, I believe, was included in the first draft of the asset purchase agreement.

I submit there is another document in the record which shows that there was an allocation by San Francisco on its books of $350,000 between the four buildings.

Then I asked J. Russell Gramlich as to whether or not he could deny that $350,000 was paid by San Francisco to the Terrydale Management Corp. or the Gramlich interests, and he could not.

I submit, your Honor, that the fair inference is that there was a secret payment by San Francisco to the Gramlich interests which was in effect a commercial bribe.

That meant, if that is so — and I say to your Honor these are fair inferences to draw from the testimony, given San Francisco's proclivity to making secret deals and payments to lawyers for witnesses, and also in terms of making flat misrepresentations to this court per the Chappell and Mann affidavits — that under the circumstances that would have meant that the Gramlichs, even without control and domination, would not have been able under those circumstances to vote on the transaction, given the fact that there would be a commercial bribe.

Thus, San Francisco, of course, had actual knowledge of the payment. They reflected it on one of the documents that they

have. Under those circumstances, and (83) with those inferences, that would change the result.

In addition, your Honor, there was a Farber document, which your Honor excluded from evidence, which showed that he had come up with a number of $3.7 million in 1981 when Chappell had asked Mr. Farber to do a valuation on 101 University. That showed, your Honor, that it was consistent with his valuation here, which was at $3.8 million.

Under the circumstances, it should have been admitted for the purposes of showing the consistency of what Mr. Farber believed, plus the fact there was a document that was not turned over to us by San Francisco, but which Mr. Farber's file had, in which Mr. Farber said to Mr. Chappell that the value of 101 University is at least the purchase price.

Then Mr. Chappell sent a letter back and said "Thank you for telling me that the value is not higher than the price we are paying."

Those are two critical differences, your Honor, because basically — and Mr. Farber — and if given an opportunity, Mr. Farber made the statement, and this I was not permitted to bring out with your Honor because of the fact that I was precluded from going into what was said back in that transaction when San Francisco had retained Mr. Farber — and Mr. Farber had told Mr. Chappell that's a (84) hell of a buy — and I would consider that as an offer of proof, if an offer of proof was necessary. This is a non-jury trial. We are not dealing with a jury trial.

MR. KRAUS: He is disclosing information which should not be disclosed, and which your Honor already knew about.

THE COURT: I really don't feel the occasion of this motion is to revisit the evidentiary rulings made by the court during the trial.

Mr. Bender, the half-hour hour that you requested is just about over.

MR. BENDER: I think I have three more minutes, your Honor.

THE COURT: I see you have been keeping track of time, as I have.

MR. BENDER: Your Honor, the fact of the matter is that one of the important factors is the credibility of Mr. Chappell and Mr. Mann. They were not produced to testify here by San Francisco, and I think with all that we have against them in terms of San Francisco doing this what I consider to be illegal conduct, and misrepresentations to this court, I think your Honor would have to view their testimony, and under the circumstances would have to draw inferences which I think arguably could very well be drawn in our favor rather than in favor of San Francisco.

(85) Under those circumstances, your Honor, it is for this reason why I think not so much a retrial as an extended reargument in terms of the details —

THE COURT: Let's assume I granted your motion, and we had a new trial. Play out the scenario to me.

We have a new trial, and we recall these witnesses. The witnesses are asked, or counsel are asked, what fee arrangement was made.

MR. BENDER: And the conversations.

THE COURT: And that evidence then is before the court. And then plaintiffs rests.

MR. BENDER: That is correct, your Honor. In other words, I would put on the three lawyers. I would call — I wouldn't need Mr. Kostoryz. There are five other people, your Honor.

THE COURT: So I would then have before me —

MR. BENDER: It would be limited, your Honor.

THE COURT: So I would then have before me the present record —

MR. BENDER: Correct, your Honor.

THE COURT: Plus the testimony of the agreement by SFREI to pay the legal fees.

MR. BENDER: That is correct, your Honor.

THE COURT: Then the record would be closed?

MR. BENDER: No. One more thing, I (86) believe. I believe, your Honor, in light of the fact that these witnesses were coached in the way they were — lawyers are entitled to give legal advice, not illegal advice, and illegal is not privileged, your Honor. I don't have to argue that point to your Honor. It is necessarily a truism.

THE COURT: What you are saying is the consequence of the agreement between the lawyers with respect to reimbursement of legal fees, or the payment of legal fees, not reimbursement —

MR. BENDER: Correct, the payment.

THE COURT: — is such that the attorney-client privilege is vitiated so that you can go into the question of what advice was given by counsel to the witnesses?

MR. BENDER: On certain areas, your Honor. On areas about this payment, for example, as to whether or not there was any such. And also, if your Honor please, I think I would be able to delve into the limited area, since we are dealing with the issue of whether or not there was an intent to influence these witnesses, I shouldn't be barred from showing, if I can, through the witnesses, whether there was an intent to influence largely in terms of that agreement and the payment of the legal fees, but also where your Honor has relied, for example, on J. Russell—

(87) THE COURT: Were you under any apprehension, skilled and experienced counsel that you are, when you were examining these witnesses, as to where their loyalties lie?

MR. BENDER: I recognized their loyalties lay with John Gramlich, your Honor, no question about that. The thing I didn't know —

THE COURT: And did you regard John Gramlich as being somebody who was sympathetic to the Grace interests?

MR. BENDER: Sympathetic to the Grace interests? Not at all.

THE COURT: You knew that. You knew you were examining witnesses who, if to any extent they sought to color or provide nuances in favor of one side or the other, that you were dealing with witnesses who were essentially hostile. You knew that, didn't you?

MR. BENDER: Yes. But there is a big difference between —

THE COURT: You knew that, Mr. Bender, and the court knew that.

MR. BENDER: There is a big difference, your Honor, between knowing that bent toward leaning, if your Honor please, and the fact that San Francisco has paid Steve Umin and David Welte to prepare these witnesses to testify. That is going over the line, Judge.

I think we should have a common rule. I (88) remember at the beginning of the trial — not at the beginning of the trial, way early in the game, after we had settled with the Gramlichs, your Honor said to me "I can't enforce against these former trustees a hold on them that if they deviate in their testimony, or something like that, that I am going to claim some kind of indemnification."

There was some broad language —

THE COURT: This was something absolutely unenforceable.

MR. BENDER: You were correct, and I adhered to your proposition. Here I was playing the game by the rules and my adversary wasn't. That's what I object to, Judge.

THE COURT: I think you have made your position very clear.

Mr. Kraus.

MR. KRAUS: I have no intention of going on at long as Mr. Bender. It sounds to me as though he is just rearguing the case, and he doesn't show what difference there would have been in any of the testimony or the proof your Honor has heard.

He hasn't shown what difference our payment of these fees would have made with respect to the testimony that was adduced at the trial or any of the valuation issues.

The record ought to be clear, by the way, Mr. (89) Bender paid Umin's and Welte's fees as well. There was a provision in the settlement agreement that obligated him to pay $10,000 toward the continuing attorney's fees of the DRD trustees.

He also paid their expenses for coming here for the trial.

He also in his review of the facts substantially mischaracterizes the record. I don't want —

THE COURT: Silence is not acquiescence.

MR. KRAUS: It is alleged it is, as it was in connection with the sanction motion.

The allegations that witnesses were coached is also outrageous. Frankly, your Honor, I think we can shorten this if I just am permitted to incorporate my comments of yesterday into the record of today with respect to the allegations of violations of 18 USC 201 (c) (2). We see new conceivable purpose in a new trial of this matter.

THE COURT: The following constitutes the courts opinion on rule —

MR. BENDER: May I say something about the $10,000?

THE COURT: I think, Mr. Bender, if you didn't have the last word on every matter you would be distressed, so go ahead..

MR. BENDER: The $10,000 was fully disclosed. (90) It was part of the agreement your Honor ordered. The expenses were also disclosed. They were out of pocket. The $10,000 was exhausted way before we came to trial, and If anything that was a reduction of the settlement amount, instead of their paying 575 in cash in net effect they paid 565. Nothing further.

THE COURT: The following constitutes the Court's opinion and ruling on the motion made on behalf of Terrydale Liquidating Trust to set aside the Court's findings of fact and conclusions of law.

If the fact-finder in this case had been a jury the issues presented by the motion would be considerably more troublesome because the issue would be the extent, if any, to which the issues raised by TLT's motion could be said to have impacted on the jury's evaluation of the credibility of these witnesses, and the impact that that would have had on the ultimate conclusion of the case.

Having been the fact-finder in this bench trial, this court is in a unique position to evaluate the impact of those issues.

As the Court indicated in colloquy yesterday, and as was reiterated in the colloquy with counsel for TLT just a few moments ago, no one in this courtroom was under any illusion or misapprehension as to the allegiance of loyalties of the witnesses whose legal fees have now been (91) disclosed to have been paid by counsel for SFREI.

Clearly, there is no need to grant a new trial if it would be a futile matter. In other words, this court is in position to determine what impact, if any, on the ultimate result there would be if the record were reopened, as I indicated, by TLT's counsel, the wit-

nesses previously called, or the attorneys, were to testify to the fee arrangement that had been made. If the court had been fully apprised during the trial of an agreement by SFREI to pay these witnesses' legal fees, that knowledge would not have altered in any fashion meaningful for purposes of this motion the Court's evaluation of these witnesses' credibility nor the ultimate outcome of the case.

I emphasize this is the sole issue before the court. We do not opine on whether the conduct of SFREI's counsel was violative of any penal stature, code of professional responsibility, or duty of candor to the court. Those are different issues. We deal here solely with the question raised by the motion, The only question raised by the motion, whether a new trial is warranted for the purposes of bringing to the court's attention the existence of this fee arrangement. We conclude that it is not.

Counsel for TLT has argued that with that information before the court different inferences would be drawn. As I have already stated, the court was at all (92) times during this litigation aware of the loyalties and allegiances of the witnesses, and the fact that legal fees were being reimbursed would not have altered the Court's evaluation of the testimony of those witnesses, nor, surely, would it have altered the ultimate result. Accordingly, the motion is denied.

The court will take a five-minute recess, after which time I will take up the two other remaining matters.

(Recess)

THE COURT: We will resume.

• • •

(97) THE COURT: . . . Is there anything else with respect to this judgment?

MR. BENDER: I, of course, note my objections, and my exception, your Honor.

THE COURT: Yes. But those are your underlying objections on the merits. Insofar as the form is concerned, and insofar as it is an accurate reflection of the rulings I have made, you have no objection.

MR. BENDER: That is correct.

THE COURT: All right. I will sign the final order.

• • •

(104) THE COURT: I have signed the final judgment.

MR. KRAUS: One thing briefly, your Honor.

There have been all these charges about Section 201, and, your Honor, it is clear there wasn't any violation.

Your Honor made reference to the duty of candor this morning. I just want to say, to your Honor, I don't know if your Honor thinks that I was not candid or whether I had a duty. When I sat there and heard the witnesses say that they didn't know about the agreement that was the first time that I knew that they didn't know, and I was certainly not — it was not on my mind not to be candid with the court. It just never occurred to me that I should (105) have — and I don't think I should have — stood up and said, "Well, there is an agreement." I just assumed that if your Honor was interested you would have asked me.

I didn't want you to think I was not being candid, or Mr. Garfinkel, or anybody else. If you do think that, I apologize, because it wasn't my intention.

THE COURT: I appreciate your rising and making that comment. It is always easy in hindsight to say that something would have been preferable. I am satisfied, as I indicated in my opinion, that had it occurred there would have been no difference in my perception of the witnesses or their credibility or where there allegiance or loyalty was.

I don't know whether in a circumstance in which a witness is testifying to his ignorance of any fee arrangement, where there has been an arrangement, and the lawyers are present in court, just what should have occurred. Of course, in terms of the witness' testimony, the witness' state of mind, what was significant was his knowledge.

I think if one could replay play it one should at least consider the possible alternative of having requested a robing room conference and to have said, or to have one of the attorneys say, "This witness doesn't know of this, and, therefore, there is no basis insofar as his (106) credibility and insofar as his motivation, he is unaware of the fact, but your Honor should be aware of the fact that an arrangement has been made."

As I say, it is very easy after the fact to rewrite the script. My only reference to duty of candor in my exclusion of issues was I didn't want anyone to think that the sole constraints on counsel are the constraints imposed by the penal laws or the explicit provisions of the code of professional responsibility.

Therefore, I simply said I'm excluding, because it is not what is the issue before me, those three things which I think are the three things which determine how counsel should conduct themselves, and I was not meaning to cast any negative implications by that reference.

I appreciate your concern about that issue, and I don't think any more need be said.

MR. KRAUS: Thank you, your Honor.

MR. BENDER: Thank you, your Honor.

No. 88-433

Supreme Court, U.S.
FILED
OCT 11 1988
JOSEPH F. SPANIOL, JR.
CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1988

TERRYDALE LIQUIDATING TRUST,

Petitioner,

– against –

HERBERT BARNESS, JOHN F. BISHOP, EDGAR H. CHAPPELL, CHARLES W. CORBITT, GEORGE S. MANN, BROOKS WALKER, JR., LOUIS W. WALKER, and CHARLES M. WILLIAMS, individually and as Trustees of, and DAVID B. BRYANT as Trustee of, SAN FRANCISCO REAL ESTATE INVESTORS, and KEITH L. BROWN, individually, and SAN FRANCISCO REAL ESTATE INVESTORS, INC.,

Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit

RESPONDENTS' BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI

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Counsel of Record for Respondents San Francisco Real Estate Investors, Inc. and its directors

October 11, 1988

QUESTION PRESENTED

Whether, in this seven-year long litigation, the district court's decision on the merits, which followed a fourteen-day bench trial, and the court's subsequent $1.5 million contractual attorneys' fee award to respondents, should be set aside based upon petitioner's inflammatory and unsupported charges of "fraud on the court" and "witness tampering," raised for the first time long after the petitioner was aware of the matters complained of, when (i) the district court fully considered and rejected petitioner's claims on multiple occasions and (ii) the Second Circuit affirmed the district court's judgment in a *per curiam* opinion and ruled that petitioner's claims were "without any merit whatsoever."

LIST OF PARTIES
(Complete Case Caption Below)

TERRYDALE LIQUIDATING TRUST,
Plaintiff-Appellant,

-vs-

HERBERT BARNESS, JOHN F. BISHOP, EDGAR H. CHAPPELL, CHARLES W. CORBITT, GEORGE S. MANN, BROOKS WALKER, JR., LOUIS W. WALKER, and CHARLES M. WILLIAMS, individually and as Trustees of, and DAVID B. BRYANT as Trustee of, SAN FRANCISCO REAL ESTATE INVESTORS, and KEITH L. BROWN, individually, and SAN FRANCISCO REAL ESTATE INVESTORS, INC.,
Defendants-Appellees.

SAN FRANCISCO REAL ESTATE INVESTORS, INC., a Delaware corporation, successor in interest to San Francisco Real Estate Investors, a California real estate investment trust,
Counterclaimant and Third-Party Plaintiff,

-vs-

TERRYDALE LIQUIDATING TRUST, a New York business trust; TERRYDALE REALTY TRUST, a Missouri business trust; OLIVER R. GRACE, OLIVER R. GRACE, JR., EMILIO G. COLLADO, WILLIAM BOLTON, and ROBERT A. POSNER, individually and as Trustees of TERRYDALE LIQUIDATING TRUST; J. RUSSELL GRAMLICH, J. HARLAN STAMPER, THOMAS J. MURPHY, JOHN D. O'FLAHERTY, and JOHN J. GRAMLICH, individually and as Trustees of TERRYDALE REALTY TRUST; LINCOLN TOWER BUILDING CO., a Colorado partnership, SUBDALE CORPORATION, a New York corporation, MORRIS, LARSON, KING, STAMPER & BOLD, a Missouri professional corporation, HARRY A. MORRIS, ROY A. LARSON, THOMAS E. KING, J. HARLAN STAMPER, LAWRENCE R. BOLD, LYNN C. HOOVER, DONALD H. LOUDON, GORDON N. MYERSON, STEVEN H. GOODMAN, TOMMY W. TAYLOR, LAURENCE R. TUCKER, DAVID M. RHODUS, ROBERT B. KEIM, JACK W. ISLEY, JR., THOMAS R. LARSON, STEVEN G. EMERSON, GREGORY M. KRATOFIL, JOHN A. KOEPKE, and JOHN R. COCKLE, individually and as partners of MORRIS, LARSON, KING, STAMPER & BOLD,
Counterdefendants and Third-Party Defendants.

RULE 28.1 STATEMENT

1. San Francisco Real Estate Investors, Inc. changed its name to REIT of America, Inc. and subsequently was acquired by and merged into Unicorp American Corporation.

2. The parent company of Unicorp American Corporation is Unicorp Canada Corporation.

3. The partially owned subsidiaries and affiliates of Unicorp American Corporation are as follows:

Airport Hotel, Inc.
American Medical Buildings, Inc.
Lincoln Development, Inc.
Mark Resources, Inc.
Midland Doherty Financial Corporation
Precambrian Shield Resources Ltd.
Townsview Investments Limited
Townsview Properties Limited
Union Enterprises Ltd.

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OCTOBER TERM, 1988

TERRYDALE LIQUIDATING TRUST,

Petitioner,

— against —

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Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit

RESPONDENTS' BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI

Respondents San Francisco Real Estate Investors, Inc. and its directors (collectively, "SFREI") submit this brief in opposition to the petition for a writ of certiorari (the "Petition") filed by Terrydale Liquidating Trust ("TLT") seeking review of the Second Circuit's *per curiam* opinion affirming the judgment of the district court in this case. In its opinion, the Second Circuit summarily rejected, as "without any merit whatsoever," all the claims of impropriety raised in the Petition.

STATEMENT OF THE CASE

The pending petition for certiorari represents the culmination of seven years of litigation in which petitioner TLT has sought, without success, to recover a multi-million dollar award of damages and other relief against SFREI in connection with SFREI's role as a "white knight" in a hotly contested corporate takeover. After a fourteen-day bench trial in 1986, Judge Leonard B. Sand of the United States District Court for the Southern District of New York rejected each and every claim advanced by TLT. Moreover, Judge Sand subsequently ruled that TLT was liable to SFREI for its attorneys' fees and expenses — totalling more than $1.5 million — pursuant to the terms of so-called "prevailing party" clauses contained in certain contracts between SFREI and TLT's predecessor, Terrydale Realty Trust. Thus, what began as an effort by TLT to recover substantial damages from SFREI ended with SFREI recovering a significant monetary award from TLT.

After losing at trial, and faced with the prospect of a large judgment against it for SFREI's attorneys' fees and expenses, TLT desperately sought shelter. First, TLT brought a motion for sanctions against SFREI — the requested "sanction" being denial of all fees and expenses — on the ground that SFREI and its counsel had "defrauded" the court in connection with a motion to dismiss for lack of personal jurisdiction brought by SFREI at any early stage of the case and ultimately denied by the district court.[1] Next, TLT moved — more than one year after the trial in this action and on the eve of the entry of final judgment awarding SFREI its fees — to re-open discovery and for a new trial pursuant to Fed. R. Civ. P. 60(b) on the ground that SFREI and its counsel had allegedly "tampered" with witnesses in violation of the federal anti-bribery statute, 18 U.S.C. § 201. TLT sought relief vacating SFREI's judgment on the merits and again asked that SFREI's fee award be denied.

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[1] At the time of the motion to dismiss, SFREI was represented by the New York firm of Rogers & Wells and the San Francisco firm of Landels, Ripley & Diamond.

The district court rejected each and every one of TLT's spurious allegations. In fact, the district court rejected TLT's claims respecting SFREI's personal jurisdiction motion not once, but three times. As for TLT's outrageous and wholly unsupported claim of "witness tampering," Judge Sand stated that he had "regretfully reached the conclusion that the desire for delay, plus other emotional aspects which have entered into this case, are motivating [TLT's motion for a new trial]." (196a)[2] On appeal, a panel of the Second Circuit (Oakes and Miner, CJJ, and Pollack, DJ) affirmed the district court's judgment in all respects in a *per curiam* opinion, and found TLT's claims of a fraud on the court and witness tampering to be "without any merit whatsoever." (9a)

Despite the fact that TLT's claims have been resoundingly rejected both by the district court and by the Second Circuit, TLT persists in advancing these false allegations as the basis for its Petition. As is clearly revealed in Point III of TLT's Petition, its sole purpose continues to be its desire to escape from the judgment against it on the merits and from the $1.5 million fee award recovered by SFREI.

Unfortunately, the charges made by TLT in its Petition, though entirely without merit, are nothing new for TLT. Throughout the seven-year history of this litigation, charges of "fraud" and "deceit" have rolled regularly and lightly off TLT's tongue, and it has been ready with a charge of fraud or its equivalent to explain virtually every difficulty or adverse ruling it has suffered in this case.[3] In this manner, TLT has managed to accuse each

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[2] References to petitioner's separately bound Appendix are indicated by page number, followed by "a".

[3] Some of TLT's charges have been truly Kafkaesque. For example, in a memorandum of law dated July 23, 1984 in opposition to SFREI's renewed motion for summary judgment (which was granted in part by the district court), TLT accused SFREI of "concealing" or destroying documents — and asked the court to "infer" that SFREI was therefore liable to TLT — because no documentary proof of TLT's claims could be found. (Plaintiff's Brief in Opposition to Defendants' Motion for Summary Judgment and in Support of its Countermotion

(Footnote continued)

of the three law firms which have represented SFREI of committing assorted "frauds on the court," and has also challenged the integrity of several of SFREI's directors.

TLT's mud-slinging charges have never once been found to have merit. As shown below, the claims in its Petition are wholly unsupported by the facts and the law, and raise no issues worthy of review by this Court.

A. *Background*

On January 9, 1981, BCG Associates ("BCG"), a New York limited partnership, made an unsolicited partial tender offer for 34% of the shares of Terrydale Realty Trust ("TRT"), a Kansas City, Missouri real estate investment trust or "REIT," at $33.50 per share in cash. The shares sought by BCG, when added to the 17.9% interest it already owned, would have given it absolute control of TRT. (4a, 17a)

With the assistance of experienced legal and real estate advisors, the TRT trustees reviewed the BCG offer and determined that, although the price was within the range of fairness (4a, 39a), it had numerous disadvantages for TRT's shareholders. (4a) Not the least of these was the fact that the BCG bid was only a partial offer, following which TRT shareholders would be left holding a minority interest in an entity in which majority control had passed to one party. (4a, 17a, 32a, 46a-47a) Accordingly, the TRT trustees determined to seek financial alternatives to the BCG offer that would be more advantageous to all of TRT's shareholders. (4a, 17a)

After holding discussions with at least eight different entities, including BCG, the TRT trustees determined (i) to sell TRT's four Denver office buildings, representing about 80% of TRT's

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for Partial Summary Judgment on Liability, p. 61) Earlier, at the deposition of Herbert Barness, a SFREI trustee, TLT's counsel accused SFREI's counsel of dereliction of his responsibilities for not preparing Mr. Barness to testify regarding certain facts which the witness testified he could not recall. (Transcript of Herbert Barness Deposition, pp. 100-104)

assets, to SFREI, at prices set forth in recently obtained appraisals, and (ii) to liquidate TRT and distribute the proceeds to shareholders. The proceeds of the sale to SFREI and liquidation of TRT yielded a total distribution to TRT shareholders of $33.85 per share for 100% of TRT's shares — a far better result for TRT's shareholders than that presented by BCG's partial offer. (4a-5a, 17a)[4]

Despite the announcement of TRT's "white knight" transaction with SFREI, BCG nevertheless continued with its tender offer for TRT shares. Through its tender offer (which was only partially subscribed) and a series of open market purchases thereafter, BCG was able, by January 1982, to obtain control of TRT, which by that time had been converted to a liquidating trust known as Terrydale Liquidating Trust, the petitioner herein. (5a-6a, 68a) BCG then caused TLT to sue the former TRT trustees and SFREI,[5] alleging, *inter alia*, that the TRT trustees had breached their fiduciary duty by selling the Denver buildings to SFREI at "fire sale" prices, and that SFREI (i) had aided and abetted this breach or, alternatively (ii) held the properties as a "constructive trustee," having purchased them with knowledge of the alleged breach. (5a-6a) After the former TRT trustees settled, TLT proceeded against SFREI alone. (6a)

B. *The Trial*

In 1986, a 14-day non-jury trial was held before Judge Sand of the United States District Court for the Southern District of New York. (7a) Judge Sand heard sixteen witnesses, all but two of whom were called by TLT. The witnesses included not only the former TRT trustees, but also real estate valuation experts presented by both sides.

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[4] The district court explicitly found that SFREI's offer was the best offer available. (32a, 48a)

[5] Thus, as both the district court and the court of appeals found, plaintiff-petitioner TLT is, in effect, the "defeated tender offeror." (5a, 120a)

On August 26, 1986, Judge Sand ruled in favor of SFREI on all issues. (13a *et seq.*) Based upon the expert testimony he had heard, Judge Sand concluded that there had been no "fire sale," and that the prices paid by SFREI for TRT's Denver properties were fair and reasonable. (38a-49a) Judge Sand also found significant the facts that none of the other potential "white knights" contacted by TRT was willing to offer more than SFREI (32a, 39a-40a) and that BCG's principals declined to bid for TRT's most valuable building when it was offered to them, shortly after their tender offer, at a price substantially below what they claimed to be its true value. (41a-42a)

In addition, Judge Sand found that (1) the former TRT trustees had not breached any fiduciary duties, but rather had acted independently, reasonably and with due care in rejecting the BCG bid and accepting the higher competing SFREI offer, which was the highest and best offer received by TRT; and (2) even if, contrary to his findings, the TRT trustees had breached their fiduciary duties, SFREI did not have the requisite knowledge of such breach to make it liable as an aider and abettor or "constructive trustee." (27a-33a; 49a-55a)

C. *SFREI's Post-Trial Claim For Attorneys' Fees and Expenses*

Immediately following Judge Sand's decision on the merits, SFREI applied to the district court for an award of its reasonable attorneys' fees and expenses from TLT pursuant to the terms of identical "prevailing party" clauses appearing in each of the four purchase-and-sale agreements between SFREI and TRT relating to the four Denver properties which had been the subject of the lawsuit. TLT opposed this application on the ground, *inter alia*, that SFREI and its counsel were guilty of "unclean hands" because they had allegedly "concealed" facts and had made a "material misrepresentation" to the court in 1982 and early 1983 in connection with a motion to dismiss for lack for personal jurisdiction.

On October 24, 1986, in an opinion reported at 645 F. Supp. 920 (S.D.N.Y. 1986), Judge Sand held that SFREI was entitled to recover its fees and expenses. Judge Sand explicitly rejected

TLT's claims regarding SFREI's personal jurisdiction motion, stating:

> Finally, we reject TLT's claim that SFREI is "guilty of unclean hands" because it concealed "true facts" when it moved early in this litigation to dismiss the complaint for lack of personal jurisdiction. See Plaintiff's Memorandum of Law at 12. This Court ultimately rejected SFREI's lack of personal jurisdiction defense. *However, SFREI's assertion of this defense does not constitute "unclean hands" and thereby warrant denial of its motion for attorney's fees.*

645 F. Supp. at 925 (emphasis added).

In accordance with Judge Sand's directions in his October 24 ruling, SFREI thereafter filed a detailed fee application, to which TLT filed specific objections, including an objection to any recovery of fees for SFREI's personal jurisdiction motion. In an unpublished opinion dated April 15, 1987, Judge Sand ruled on TLT's objections and held that SFREI's fee application should be reduced in certain limited respects, including the elimination of fees relating to the personal jurisdiction motion. The court then directed SFREI to submit a revised fee application in accordance with its rulings. SFREI's revised fee application was filed May 15, 1987, and sought over $1.5 million in attorneys' fees.

D. *TLT's Motion for Sanctions*

On June 22, 1987, in response to SFREI's revised fee application, TLT filed a motion for sanctions, claiming, once again, that SFREI's assertion by motion of its personal jurisdiction defense in 1982 and early 1983 constituted a "fraud on the court" and warranted complete denial of SFREI's contractual right to attorneys' fees. Although recognizing that Judge Sand had already rejected this argument in his October 24, 1986 opinion, TLT pointed to a truncated portion of a quotation from Judge Sand's April 15, 1987 opinion, in which Judge Sand stated that SFREI's personal jurisdiction motion was "entirely devoid of merit"; TLT attempted to argue that this language supplied a new ground for overturning SFREI's entire fee award.

This argument was wholly disingenuous, as was obvious from the full text of the quote, which appears at page 4 of the district court's April 15, 1987 opinion. There, speaking of SFREI's personal jurisdiction argument, the court stated:

> Although *we rejected TLT's claim that SFREI lacked "unclean hands" because it asserted this claim (with the alleged consequence urged by TLT but rejected by the Court, that SFREI forfeited any right to recovery, see* Opinion, October 24, 1986, p.12), we believe the claim was entirely devoid of merit.

(Slip Op. at 4) (emphasis added).

The full text of this quote makes clear that Judge Sand did not hold or even imply that SFREI's personal jurisdiction defense had been asserted in bad faith or through fraud or deceit, as TLT attempted to suggest. Rather, he simply found that it was an unsuccessful claim, the cost of which, on balance, should not be taxed against TLT.[6]

Not surprisingly, Judge Sand rejected TLT's sanctions motion in no uncertain terms, observing that this was "the third time" that TLT had requested him to rule on "essentially what are the same issues." (168a) Judge Sand stated:

> First, with respect to the motion by Terrydale Liquidating Trust for Rule 11 sanctions with respect to the assertion of jurisdictional defenses by SFREI which the Court determined to be "devoid of merit," that motion is denied, and as I indicated in my colloquy with counsel, I considered sua sponte, when this issue was previously raised, what sanctions would be appropriate

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[6] Petitioner now quotes the "entirely devoid of merit" language once again, in support of its argument to this Court. (Pet. Br. 4) Yet TLT fails to provide the full quotation, which makes clear that Judge Sand gave no credence whatsoever to TLT's "unclean hands" or "fraud on the court" allegations. Such tactics come with ill grace from one who freely accuses reputable lawyers of misconduct.

> in the total context of this litigation, and nothing has been called to my attention which convinces me that the sanction that I adopted, which was to deny SFREI's application for attorneys' fees for time expended in connection with that application, was incorrect.

(194a-195a).

E. *TLT's Motion to Reopen Discovery*

In addition to its disingenuous sanctions motion, on August 7, 1987 — more than a year after the close of the trial — TLT moved for discovery regarding SFREI's agreement to pay the attorneys' fees of certain witnesses at trial. (143a) TLT contended that such agreement constituted "witness tampering" in violation of the federal anti-bribery statute, was a violation of the Code of Professional Responsibility, and was a "fraud on the court," requiring a new trial and, of course, denial of SFREI's fee award.

The undisputed facts regarding this matter in no way support TLT's claims. SFREI made no payments to any witnesses, but did pay the fees and expenses of two law firms — Williams & Connolly of Washington, D.C. and Polsinelli, White & Vardeman of Kansas City — for representing the former TRT trustees[7] and Michael Gramlich and James Kostoryz in connection with their preparation for and testimony at the trial. (146a-147a, 159a, 161a)[8]

SFREI agreed to make these payments at the request of representatives of these two firms — Steven M. Umin, Esq. of Williams & Connolly and David A. Welte, Esq. of the Polsinelli firm — who had represented the TRT trustees continuously since before the BCG tender offer in 1981. They contacted SFREI's counsel prior to the trial, explained that they doubted whether their clients would be willing or able to pay the legal fees and expenses that would be incurred for preparing them for their

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[7] The former TRT trustees were J. Russell Gramlich, his son John J. Gramlich, J. Harlan Stamper, John D. O'Flaherty and Thomas J. Murphy.

[8] These fees and expenses totaled $26,714.15 for Williams & Connolly, and $25,052.33 for the Polsinelli firm. (146a, 159a, 161a)

testimony and representing them at trial, and asked if SFREI would be willing to pay these costs. (146a) SFREI agreed, because it believed that the trustees should have the benefit of Messrs. Umin's and Welte's independent counsel in connection with their trial testimony, since these two lawyers were thoroughly familiar with the background of this litigation, were well known to the trustees and had represented them previously in this litigation and predecessor actions. (147a)

At no time was there ever any discussion, or even the suggestion, that SFREI's willingness to cover Messrs. Umin's and Welte's fees and expenses was contingent in any way upon the testimony of their clients or the outcome of the trial. (147a, 159a, 161a) Messrs. Umin and Welte functioned completely independently in their representation of their clients at the trial, and no one connected with SFREI had any contact with these witnesses regarding the litigation, discussed with them any testimony they might give, or attempted to influence their judgment or conduct in any respect. (*Id.*) Finally, no one from Skadden Arps, SFREI's counsel, ever had any contact whatsoever with any of the former TRT trustees, Michael Gramlich or James Kostoryz, other than seeing and examining them in court at the trial and at their depositions noticed by TLT. (147a)

At the trial, TLT's counsel examined these witnesses extensively on the subject of the payment of their legal fees. As their trial testimony clearly shows, none of the witnesses knew, at the time of the trial, that SFREI had agreed to pay their lawyers' trial-related fees and expenses. (149a-157a) Moreover, Messrs. Umin and Welte swore in affidavits that they never advised the TRT witnesses of the fee arrangement prior to or during the trial, and they believed that the witnesses were unaware of the arrangement. (159a, 161a-162a)

Significantly, during all of the trial testimony, the lawyers for the witnesses — Messrs. Umin and Welte — were present and available in the courtroom. TLT's counsel was obviously free to call them to the stand and inquire as to the payment of their fees. TLT's failure to make such an inquiry of these two lawyers

can only be construed as a tactical decision designed to give TLT the basis for a later motion if its case was rejected on the merits.

At a lengthy hearing on August 27 and 28, 1987, Judge Sand firmly rejected TLT's motion to re-open discovery on the attorneys' fee issue, as well as a last-ditch motion for a new trial, based on the same grounds, that the court had permitted TLT to make orally. (*See* hearing transcript at 167a *et. seq.*)

With respect to TLT's motion for discovery, which the court treated as "a discovery motion in support of a contemplated motion to set aside a fact-finding in a civil case" (195a), the court held:

> The discovery motion is denied on several grounds, the principal ones being that, assuming the truth of the allegations, the Court does not perceive how it could have impacted on the ultimate determination on the merits which the Court made in the case tried to the bench.
>
> The relationship of the witnesses to the parties, where their sympathies lie, where they perceive their self-interest to lie, was quite apparent during the course of the trial to the Court. It certainly should have been quite apparent to Mr. Bender [TLT's counsel]. *And if he had thought that the matter was worth pursuing further at the trial, he had the opportunity to do so.*

(195a-196a) (emphasis added).

With respect to TLT's motion for a new trial, Judge Sand held:

> As the Court indicated in colloquy yesterday, and as was reiterated in the colloquy with counsel for TLT just a few moments ago [211a-212a], no one in this courtroom was under any illusion or misapprehension as to the allegiance or loyalties of the witnesses whose legal fees have now been disclosed to have been paid by counsel for SFREI.

> Clearly, there is no need to grant a new trial if it would be a futile matter. In other words, this court is in position to determine what impact, if any, on the ultimate result there would be if the record were reopened, as I indicated, by TLT's counsel, the witnesses previously called, or the attorneys, were to testify to the fee arrangement that had been made. If the court had been fully apprised during the trial of an agreement by SFREI to pay these witnesses' legal fees, that knowledge *would not have altered in any fashion meaningful for purposes of this motion the Court's evaluation of these witnesses' credibility nor the ultimate outcome of the case.*
>
> • • •
>
> Counsel for TLT has argued that with that information before the court different inferences would be drawn. As I have already stated, the court was at all times during this litigation aware of the loyalties and allegiances of the witnesses, and *the fact that legal fees were being reimbursed would not have altered the Court's evaluation of the testimony of those witnesses, nor, surely, would it have altered the ultimate result.* Accordingly, the motion [for a new trial] is denied.

(214a-215a) (emphasis added).

Ultimately, the district court viewed petitioner's motions for what they were — tactical devices born of frustration and TLT's desire for delay. Judge Sand stated:

> There must be an end to this matter, and the Court has regretfully reached the conclusion that the desire for delay, plus other emotional aspects which have entered into this case, are motivating such an application [for a new trial].

(196a).

F. *The Second Circuit's Per Curiam Affirmance*

On May 12, 1988, the Second Circuit, in a *per curiam* opinion, affirmed Judge Sand's "comprehensive and well-reasoned opinion" (7a), stating that his factual findings were "amply supported by the record" and agreeing with his legal conclusions and rulings "substantially for the reasons given by him therefor." (9a) The Second Circuit also affirmed Judge Sand's rulings on TLT's sanctions motion and "witness tampering" claim, finding both of them to be "without any merit whatsoever." (9a)

REASONS FOR DENYING THE PETITION

I. *The Petition Does Not Raise Any Question of "Paramount Public Importance"*

In both the district court and the Second Circuit, TLT argued that SFREI's agreement to pay the fees of the lawyers for the former TRT trustees violated the federal anti-bribery statute, 18 U.S.C. § 201, and the Code of Professional Responsibility. TLT retreats from these claims in its Petition. Instead, TLT resorts to mischaracterizing the conduct in the most inflammatory terms, and then simply contends that the Petition raises questions of "paramount public importance." (Pet. Br. 7) Nothing could be further from the truth.

As shown in Point II, below, the agreement to pay the legal fees of the TRT trustees does not violate any criminal provision or ethical proscription, or any other rule of law. To the contrary, it is expressly permitted. Moreover, as the district court repeatedly stressed, it was not "deceived" or "defrauded" by the non-disclosure of the agreement, since it always viewed the witnesses as "essentially hostile" to TLT and thus the fee agreement, even if known, would not have altered its decision on the merits in any respect.

Similarly, as shown in Point III, the Petition does not raise any important question regarding SFREI's assertion of its personal jurisdiction defense. The district court was obviously in the best

position to determine whether it had been "deceived" or "defrauded" in connection with this matter. It concluded on three separate occasions that it was not, and the Second Circuit agreed.

Finally, as shown in Point IV, TLT's claim that the "integrity of the judicial process" (Pet. Br. 8) has somehow been offended is absurd. The real issue here is how much longer TLT should be allowed to impugn the reputations of respected law firms and lawyers in what is simply a desperate effort to upset SFREI's judgment on the merits and its $1.5 million contractual fee award.

II. *The Fee Agreement Did Not Constitute "Witness Tampering" and Did Not Violate Any Criminal Provision or Ethical Rule*

There is no statute, case or ethical rule that proscribes the payment of the legal fees and expenses of counsel for a witness. 18 U.S.C. § 201(c)(2), to which TLT refers on page 9 of its Petition — without so much as a single supporting case citation — proscribes the giving, offering or promising anything of value to any person "*for or because of*" that person's trial testimony (emphasis added). A violation of this section obviously requires a connection between the payment (or offer of payment) to the witness and the testimony of the witness; there must have been a gift, award or gratuity *by reason of* some act performed or to be performed by the witness. *See United States v. Irwin*, 354 F.2d 192, 196-198 (2d Cir. 1965) (construing §201 prior to the 1986 redesignation of its subdivisions), *cert. denied*, 383 U.S. 967 (1966).

No such connection existed in this case. The payment of attorneys' fees was not contingent in any respect upon the content of the witnesses' testimony or the outcome of the trial. Indeed, the witnesses' testimony makes clear that they were not even aware that SFREI had agreed to pay their lawyers' fees. Since SFREI's payment of the attorneys' fees here was not, in the words of the statute, "for or because of" the witnesses'

testimony – *i.e.*, it was entirely unconditional – there can be no liability under Section 201(c)(2).

Similarly, SFREI's conduct does not implicate any provision of the Code of Professional Responsibility. The only Code provision even remotely on point is Disciplinary Rule 7-109(C), which only prohibits payments to a witness which are contingent upon the content of his testimony or the outcome of the case. Since no such contingent payment was made here, that Rule does not apply.[9]

In fact, DR 7-109(C) expressly permits payment of "expenses reasonably incurred by a witness in attending or *testifying*" at a trial (emphasis added). Similarly, EC 7-28, an Ethical Consideration promulgated under Canon 7, expressly permits the "reimbursement for expenses and financial loss incident to" testifying as a non-expert witness. Nothing in either the Disciplinary Rule or the Ethical Consideration suggests that "reimbursement for expenses" was meant to exclude the reasonable attorneys' fees of the witness' lawyer. To the contrary, at least two state bar ethics opinions have held that DR 7-109(C) authorizes the payment of a witness' attorneys' fees.

In Alabama Bar Ass'n Disciplinary Commission Ethics Op. 82-699 (1983) it was held that payment of a witness' attorneys' fees for consultation and attendance at a deposition would not be an "ethical impropriety" under EC 7-28 or DR 7-109(C) because such fees are a "legitimate out-of-pocket expense." Such a payment would be impermissible only if the attorney for the party willing to pay the fees (1) has knowledge or reasonable cause

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[9] It bears repeating that, not only was there no contingent fee arrangement here, but the witnesses themselves were unaware of any agreement *of any nature* to pay their lawyers' fees. (149a-157a, 159a, 161a-162a) The witnesses' lack of knowledge has independent legal significance. *See New England Tel. & Tel. Co. v. Bd. of Assessors*, 392 Mass. 865, 468 N.E.2d 263, 267-68 (1984) (holding that a tax board should not have disregarded the testimony of an expert witness on the basis of an alleged contingent fee arrangement because the evidence did not show that, at the time he testified, the expert had any belief or expectation that he then had a contingent fee arrangement).

to believe that a portion of the sum will be paid to the witness to influence the content of his testimony or (2) the payment is contingent on the content of the witness' testimony or the outcome of the case. As set forth above, no such circumstances existed in the present case.

In Florida Bar Informal Staff Op. TE083026 (1982), staff counsel advised that a party could properly pay a witness' attorneys' fees relating to that witness' obtaining immunity from prosecution. Since obtaining immunity was a prerequisite to the witness testifying at trial, such attorneys' fees were held to be expenses "reasonably incurred in attending or testifying" within the meaning of DR 7-109(C).

Petitioner asserts that Messrs. Umin and Welte became SFREI's "hired gun[s].... partners with or agents of SFREI in promoting the SFREI strategy." (Pet. Br. 10) Neither Judge Sand nor the Second Circuit gave any credence to this outrageous accusation, and with good reason. SFREI did not hand-pick these lawyers. To the contrary, they had represented the former TRT trustees for many years in connection with the very matters at issue in this litigation, and both of them swore in their affidavits that they acted completely independently in representing their clients during the trial. (147a, 158a-162a)

Judge Sand repeatedly rejected TLT's suggestion that he was "deceived" or "defrauded" by the nondisclosure of the fee agreement. The court also stressed its full awareness that the former TRT trustees were "essentially hostile" to TLT (212a), which was attempting to prove that they had committed a serious breach of their fiduciary duties. In fact, Judge Sand told TLT's counsel "You knew you were examining witnesses who, if to any extent they sought to color or provide nuances in favor of one side or the other," would favor SFREI. (211a-212a)[10]

Judge Sand concluded that, regardless of the fee arrangement, the TRT witnesses were credible, and he expressly stated: "If the

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[10] For precisely this reason, TLT's allegations throughout its Petition that the former TRT trustees were "its" witnesses are absurd. Had TLT not called these witnesses, SFREI would have done so.

Court had been fully apprised during the trial of an agreement by SFREI to pay these witnesses' legal fees, that knowledge *would not have altered in any fashion meaningful for purposes of this motion the Court's evaluation of these witnesses' credibility nor the ultimate outcome of the case.*" (215a) (Emphasis added) In effect, the Petition asks this Court to second-guess Judge Sand's findings in this regard, concerning matters which he alone properly should determine. The Second Circuit correctly rejected such an invitation, and this Court should do likewise.

III. *SFREI's Assertion of the Defense of Lack of Personal Jurisdiction Does Not Warrant Denial of SFREI's Contractual Attorneys' Fees*

TLT's claim that SFREI's assertion in 1982 and 1983 of the defense of lack of personal jurisdiction justifies wholesale denial of SFREI's contractual attorneys' fees has been explicitly rejected *four* times — three times by Judge Sand (on October 24, 1986, April 15, 1987 and August 27, 1987) and once by the Second Circuit. SFREI has always disputed, and continues to dispute, TLT's contentions regarding this matter. However, in light of the repeated rejections of TLT's claims, both by the fact-finder and the appellate court, SFREI does not believe it is necessary to respond to TLT's charges with any detailed factual refutation.

The important point is that TLT's claims of fraud and deception raise factual issues which were appropriately within the sound discretion of the district court to resolve. That court repeatedly rejected TLT's suggestion that it had somehow been "deceived" by SFREI's assertion of its jurisdictional defense. Judge Sand's rulings were affirmed by the Second Circuit, which agreed that TLT's claim was "without any merit whatsoever." (9a) The Petition simply seeks to reargue Judge Sand's conclusive factual determinations; it raises no issue of law or public policy worthy of certiorari.[11]

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[11] It is perhaps worth noting that TLT's long-arm jurisdiction claim was based on the negotiation in New York, by lawyers for SFREI, of an agreement that was collateral to one of the four purchase-and-sale agreements pursuant to which

(Footnote continued)

IV. *TLT's Claim That SFREI's Conduct Has Implicated the "Integrity of the Judicial Process" Is Without Merit*

Unable to point to a single legal issue worthy of certiorari, TLT argues that SFREI's conduct offends the "integrity of the judicial process" and demands a review by this Court. (Pet. Br. 8) This contention is simply ridiculous. It is premised on the fictitious assumption that some sort of fraud or deception actually occurred, when in fact Judge Sand repeatedly stated, and the Second Circuit agreed, that this was not the case.

The three cases cited by TLT on this point (Pet. Br. 8-11) are completely inapposite, since each one involved an affirmative finding of an actual fraud on the court, such as the manufacturing of evidence or perjury. *See Hazel-Atlas Co. v. Hartford Co.*, 322 U.S. 238 (1944) (patent applicant in an infringement case submitted into evidence a "spurious" trade journal article, ostensibly signed by a disinterested expert, but which was actually authored by the applicant's own attorneys); *Phillips v. Crown Cent. Petroleum Corp.*, 556 F.2d 702 (4th Cir. 1977), (court found that plaintiff had committed perjury at depositions and at trial), *cert. denied*, 444 U.S. 1074 (1980); *Harre v. A.H. Robins Co., Inc.*, 750 F.2d 1501 (11th Cir. 1985) (expert witness

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TRT transferred its Denver real estate to SFREI. The purchase-and-sale agreements were negotiated in Kansas City and Denver, closed in Denver and were governed by Colorado law. It is far from clear that the minimal activities taken in New York with respect to a single collateral agreement were or are sufficient to confer jurisdiction under Section 302(a)(1) of the New York Civil Practice Law and Rules over SFREI, a California business trust which did no business whatsoever in New York, and its directors. *See, e.g., McShan v. Omega Louis Brandt Et Frere, S.A.*, 536 F.2d 516, 518 (2d Cir. 1976); *Fontanetta v. American Bd. of Internal Medicine*, 421 F.2d 355, 357 (2d Cir. 1970); *Pavlo v. James*, 437 F. Supp. 125, 128 (S.D.N.Y. 1977); *Amins v. Life Support Medical Equip. Corp.*, 373 F. Supp. 654, 658 (E.D.N.Y. 1974).

Moreover, SFREI also disputes TLT's preposterous claims that Skadden Arps engaged in misconduct by (i) inserting in SFREI's answer a one-sentence defense of lack of personal jurisdiction and (ii) refusing to waive the defense in the pretrial order. (Pet. Br. 4) By so doing, Skadden Arps simply sought to preserve the defense for appeal.

found to have committed perjury at trial). These cases simply hold that when a fraud, such as perjury, has in fact occurred during the trial, the courts have an obligation to re-examine and, if warranted, set aside the verdict or decision. Here, Judge Sand examined TLT's inflammatory charges in detail and conclusively rejected them.[12]

Finally, it is also worth noting that, regardless of the fee arrangement, the court explicitly found that the prices paid by SFREI for TRT's Denver buildings were fair and reasonable and that no "fire sale" had taken place. (38a-49a) This finding was based not on the testimony of the TRT trustees, but on the testimony of the parties' real estate valuation experts and on the evidence of the "market place" (*i.e.*, the facts that SFREI's offer was the best available, and that eight sophisticated bidders examined TRT and refused to pay more than $33.50 for all of TRT's shares). Thus, there is simply no way that TLT's charges, even if taken as true, could have changed the outcome of this case.

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[12] TLT's other cases on this point are also irrelevant. In *Alexander v. Watson*, 128 F.2d 627 (4th Cir. 1942), the court held that an attorney who agreed to testify on behalf of his former client as a trial witness was not entitled to receive what was, in effect, a contingent fee for testifying. The attorney had balked at testifying until the receiver for the client promised that, if he testified, and the receiver prevailed at trial, the receiver would apply to the court for additional compensation for the attorney. The circuit court held that any agreement to pay such additional compensation, particularly given its contingent nature, was unenforceable. In the present case, the fee arrangement (i) was not contingent in any way upon the content of the TRT witnesses' testimony or the outcome of the trial; and (ii) was payment for the lawyers' actual time charges and expenses, *not* compensation for the witnesses' testimony.

In *Fund of Funds, Ltd. v. Arthur Andersen & Co.*, 545 F. Supp. 1314, 1369-1370 (S.D.N.Y. 1982), the court held that payments made *directly* to fact witnesses at trial may be relevant to a jury in assesing the witnesses' credibility. In the present case, SFREI did not make payments directly to any witnesses, but merely reimbursed their attorneys for their reasonable trial-related attorneys' fees, which, as set forth above, is entirely proper. Moreover, the witnesses did not have any knowledge of the agreement to pay such fees, so their credibility was not and could not have been affected. Finally, Judge Sand, as the finder of fact in the non-jury trial, held that even if he had known of the fee arrangement, it would not have affected his assessment of the witnesses' credibility, nor would it have affected the outcome of the case.

Conclusion

For the foregoing reasons, TLT's petition for a writ of certiorari should be denied.

Respectfully submitted,

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October 11, 1988

Supreme Court, U.S.
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No. 88-433

IN THE

Supreme Court of the United States

OCTOBER TERM, 1988

TERRYDALE LIQUIDATING TRUST,

Petitioner,

-v-

HERBERT BARNESS, JOHN F. BISHOP, EDGAR H. CHAPPELL, CHARLES W. CORBITT, GEORGE S. MANN, BROOKS WALKER, JR., LOUIS W. WALKER, and CHARLES M. WILLIAMS, individually and as Trustees of, and DAVID B. BRYANT as Trustee of, SAN FRANCISCO REAL ESTATE INVESTORS, and KEITH L. BROWN, individually, and as SAN FRANCISCO REAL ESTATE INVESTORS, INC.,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

REPLY BRIEF OF PETITIONER

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REPLY BRIEF OF PETITIONER

I. The Judgment Should Be Set Aside Because Of Respondent's Secret Tampering With Petitioner's Critical Witnesses.

In its unpersuasive attempt to defend the secret agreement to pay $50,000 for the attorneys' fees of its adversary's critical witnesses, respondent fails to address the main point of the petition: the judgment should be set aside for fraud on the court because of the nondisclosure of the agreements (negotiated by respondent and its attorneys), which affected the credibility of key witnesses whose testimony formed an integral part of the trial judgment. *Hazel Atlas Glass Co.* v. *Hartford-Empire Co.*, 322 U.S. 238 (1943). Respondent agrees that *Hazel-Atlas* requires a judgment to be set aside where there has been a fraud on the court. (RB 18-19)[1] Rather than address the question of law whether its admitted conduct constitutes a fraud on the court, respondent unsuccessfully argues the legality of the agreements. While the petition does not hinge on a violation of 18 U.S.C. §201 or the Code of Professional Responsibility, respondent's outrageous contention that its conduct is "expressly permitted by law" (RB 13) points up the need for intervention by this Court. Petitioner has shown that such conduct is clearly prohibited as a fraud on the court and is so repugnant to the litigation process that the tainted judgment must be set aside. *Hazel-Atlas Glass Co., supra.*

Most recently, this Court has emphatically shown its concern for protecting the integrity of the judicial process. Just last term, in *Liljeberg* v. *Health Services Acquisition Corp.*, 100 L.Ed.2d 855 (1988), this Court ordered a new trial under Fed. R. Civ. P. 60(b) because the district court's impartiality might reasonably have been questioned. The Court reminded that "to perform its high function in the best way 'justice must satisfy the appearance of justice,' "100 L.Ed. 2d at 875, quoting *In re Murchison*, 349 U.S. 133, 136 (citation omitted).

Liljeberg also reaffirms the well-established rule that agreements and interests which affect the partiality of the factfinder as

[1] "RB refers to Respondent's Brief in Opposition. "Pet." refers to the Petition. References to the separately bound appendix are indicated by page number, followed by "a."

well as the credibility of the witnesses must be disclosed and subject to scrutiny by the other parties to the litigation. *See also Giglio* v. *United States*, 405 U.S. 150 (1972) (new trial mandated because of nondisclosure of immunity agreement between key witness and prosecution).

Respondent concedes that "when a fraud . . . has in fact occurred during the trial, the courts have an obligation to reexamine and, if warranted, set aside the verdict or decision" relying on, *inter alia*, *Hazel-Atlas*. (RB19). Thus, respondent's only challenge raises a question of law whether its undisputed conduct constitutes fraud requiring that the judgment be vacated and that there be a "complete denial of relief" to the respondent. *Hazel Atlas*, 322 U.S. at 250. Respondent does not, because it cannot, challenge petitioner's showing that the district court relied heavily on the tainted testimony of the former TRT trustees. (Pet. 10-11). Thus, here, as in *Hazel-Atlas*, the lower court's own opinion demonstrates the materiality of the tainted evidence.

Respondent's argument that the outcome would have been the same, notwithstanding the witness tampering (1) is not true, (2) is not the issue, and (3) ignores the need for a hearing to reach that conclusion. First, in arguing that the case could be resolved based on market valuation, SFREI ignores petitioner's claims for breach of Declaration of Trust, which related to whether the non-Gramlich trustees were controlled and dominated by the Gramlich trustees and therefore depended on the testimony of those witnesses. Whether TRT had the power to sell and liquidate the trust and whether TRT's actions were *ultra vires* did not depend on the expert testimony or the marketplace.

Second, the district court ignored the standard of *Hazel-Atlas*, which demands that the courts protect the integrity of the judicial process regardless of the outcome, as it erroneously focused on whether the result would have been different, had it known of the agreement.

Third, in denying TLT's request for discovery on the content of the agreements between SFREI and the witnesses' lawyers, the district court decided the motion for a new trial based on the one-sided submission of the lawyers who negotiated those agreements

and kept them secret from the court and petitioner. The court disregarded (i) the reality that the independence of the witnesses and their counsel was destroyed by the agreements, (ii) the likelihood that the payments were contingent, (iii) the undisclosed communications between counsel for SFREI and counsel for the witnesses, and (iv) the possibility that the witnesses perjured themselves.

Phillips v. *Crown Central Petroleum Corp.*, 556 F.2d 702 (4th Cir. 1977), *cert. denied*, 444 U.S. 1074 (1980), highlights the district court's error in denying petitioner's requested discovery. In *Crown Central*, the Fourth Circuit vacated the injunction where the district court, without inquiring into the extent of the perjury, held that it would continue to credit the tainted testimony. The Fourth Circuit recognized that the district court "already" had a "substantial basis" apart from the perjured testimony to support its injunction and even may have "correctly estimated the situation." Nonetheless, the court admonished that "that is not a sufficient reason for not conducting a plenary hearing."

> Just how pervasive was that perjury, neither the judges nor the parties . . . can know. It is possible that larger parts of the intricate web of findings may be affected. . . . One must hear before one decides. *Audi alteram partem* is a fundamental rule of procedural fairness.

Id. at 705. In this case, as in *Crown Central*, the district court committed reversible error in denying the motion for discovery and new trial, thus preventing the exploration of the extent of the fraud and tampering.

An oral agreement through attorneys, who are officers of the court, to pay $50,000 in attorneys' fees for witnesses called by an adversary — which agreement is not disclosed to the court or the adversary — clearly amounts to tampering with witnesses. Respondent's argument to the contrary is a meritless distraction and its supposed authorities lend it no support whatsoever. Because

respondent has argued the Criminal Code and the Professional Code, petitioner responds accordingly.[2]

Simply stated, 18 U.S.C. Sec. 201(c) (2) *expressly* prohibits (i) "directly or indirectly" giving or promising, (ii) "anything of value" to any person, (iii) "for or because of the testimony." The payments admitted to by SFREI fit squarely within that language. The three elements of 18 U.S.C. Sec. 201(c) (2) are all satisfied: (1) direct or indirect promise or giving — satisfied here by the pretrial agreements and subsequent payments; (2) of something of value - here $50,000 in attorneys' fees; and (3) for or because of the testimony - here for the lawyers who prepared the witnesses for their trial testimony. [3]

Respondent erroneously asserts that there was no connection between the testimony and the payments under 18 U.S.C. 201 (c) (2) (RB 14). The connection is abundantly clear: the payments were to the attorneys who prepared the witnesses for their trial testimony. Beyond dispute, those attorneys were aware of who was paying their fees. Further, SFREI assumed that the witnesses were similarly aware of the agreement as is shown by the state-

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[2] TLT forcefully maintains that SFREI has violated the federal antibribery statute, 18 U.S.C. Sec.201, and the Code of Professional Responsibility. (Pet. 9). That TLT has not asserted such as independent grounds for the petition does not diminish that fact. Respondent's astonishing assertation that "[t]here is no statute, case or ethical rule that proscribes the payment of the legal fees and expenses of counsel for a witness," (RB 14) ignores the explicit language of 18 U.S.C. Sec. 201 and the natural reading of the Code of Professional Responsibility.

[3] Courts have repeatedly given the "for or because of" language of Sec. 201(c) a broad reading. *United States* v. *Evans*, 572 F.2d 455, 480 (5th Cir. 1978) *cert. denied*, 439 U.S. 870 (1978). The purpose of Sec. 201(c) is to reach any situation in which payments or gifts might cloud the judgment of the recipient. *Id.* Hence, 18 U.S.C. Sec. 201 (c) (2) proscribes the giving or offering of all gratuities. All that is required is the intent to make or offer the gift; there need be no showing that the gift was given with intent to influence conduct corruptly. *United States* v. *Irwin*, 354 F.2d 192, 196-197 (2d Cir. 1965), *cert. denied*, 383 U.S. 967 (1966) ; *United States* v. *Jackowe*, 651 F. Supp. 1035 (S.D.N.Y. 1987) . (1986 recodification of 18 U.S.C. Sec. 201 redesignated former 18 U.S.C. Sec. 201(f) and (h) as subsections (c) (1) (A) and (c) (2) respectively).

ment of its attorney, Mr. Kraus, that he was surprised by the witnesses' testimony. ("When I sat there and heard the witnesses say that they didn't know about the agreement that was the first time that I knew that they didn't know . . . "(216a)). Respondent cannot now disavow the relationship it created.

The case law repeatedly states that payments to witnesses (other than experts), especially an adversary's, are repugnant to the integrity of the judicial process. *E.g. In re Robinson*, 151 A.D. 589, 136 N.Y.S. 548, 555-57 (1912), *aff 'd*, 209 N.Y. 354 (1913) cited by the Model Code of Professional Responsibility, E.C. 7-28 n. 48. (*See also* Pet. 9)[4]

With regard to ethical violations, respondent recognizes that DR 7-109 (C) clearly proscribes any agreement which is contingent on the content of the testimony or the outcome of the litigation; but the presence or absence of a contingency has never been explored.[5] Further , while DR 7-109 (C) permits reimbursement for expenses, it does not permit reimbursement for attorneys' fees. "Expenses" is a term of art clearly understood as distinct from attorneys' fees. *See* 28 U.S.C. Sec. 1821; 28 U.S.C. Sec. 1927 (treating attorneys' fees as separate from expenses.)

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[4] SFREI's attempt to distinguish *Alexander* v. *Watson*, 128 F.2d 627 (4th Cir. 1942) on the ground that the secret agreement and payment here was "payment for the lawyers' actual time charges and expenses, *not* compensation for the witnesses' testimony" (RB 19, n. 12, original emphasis) ignores the reality that discharging the witnesses of $50,000 in attorneys' fees is plainly compensation to the witnesses.

[5] On the one hand, if the witnesses did not know who was paying their attorneys' fees, DR 5-107 was apparently violated. Messrs. Welte and Umin were required to discuss the agreements with and obtain the approval of their clients before accepting payment from a third party. On the other hand, if the lawyers did disclose, then the witnesses were lying when they said they did not know who was paying their fees. Alternatively, if the agreements were disclosed to the witnesses but were contingent (on the testimony or the outcome of the litigation), then DR 5-107 was not violated, but DR 7-109 (C) was clearly violated! In any event, the analysis magnifies the need for a hearing to untangle this web. *Phillips* v. *Crown Central, supra.*

SFREI's authorities are a sham. Surely, respondent is not suggesting that the Federal Criminal Code could be undermined by an ethics commission opinion from the Alabama Bar or an informal staff opinion from the Florida Bar. They are not relevant authority in this Court, particularly, on a petition which does not seek review of the Code of Professional Responsibility .[6] Moreover, the opinions are factually inapposite as they concern payments by a party who expected to call these witnesses as his own and patently do not authorize the *secret* payment of $50,000 in attorneys' fees for an *adversary's* witnesses.

SFREI's reliance on the Alabama opinion written in response to a telephone inquiry proves its desperation. The discussion of the payment of $3,000 to the attorney for an out of state non-party witness to appear at a deposition is written with absolutely no awareness of 18 U.S.C. Sec. 201; the proffered payment would clearly be unlawful under 18 U.S.C. Sec. 201 (c) (2). Moreover, the opinion explicity notes that if the secret payment were revealed, "the credibility of this witness would be virtually destroyed."

Respondent recasts its duty to disclose the fee agreement as petitioner's obligation to discover it (RB 10-11). That position is without any merit, particularly where respondent's counsel successfully objected to the inquiry that could have revealed the illegal agreements. [7]

Respondent further misrepresents claiming that the charge of witness tampering was "raised for the first time long after the

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[6] Both opinions are reproduced at the end of this brief for the court's convenience.

[7] When trustee Murphy testified that "one of the attorneys" told him that his attorneys' fees were going to be paid, SFREI's attorney, Kraus, successfully invoked the attorney-client privilege on behalf of the witness and his attorney to prevent TLT from discovering *which attorney* told Murphy that his attorneys' fees were going to be paid (149a). After its successful objection, SFREI is in no position to assert now that TLT was delinquent in not calling the attorneys to the stand.

petitioner was aware of the matters" (RB, Questions Presented p. (i)). In fact, TLT twice raised the issue as early as possible.[8]

SFREI's contention that the integrity of Messrs. Umin and Welte is established because "both of them swore in their affidavits that they acted completely independently" (RB 16) is nonsense. First, the agreements objectively destroyed their independence; second, these self-serving assertions have never been tested or explored under cross-examination, and thus are entitled to no weight.

SFREI misconceives the petition as a fact-finding mission (RB 17). The relevant facts regarding the tampering with witnesses are undisputed and admitted by SFREI and the lawyers for the witnesses. The question is one of law: what consequences should attach to the unquestioned wrongdoing? The courts below held that none was appropriate. The administration of justice requires this Court to review that legal conclusion.

II. The Award Of $1.5 Million In Attorneys' Fees To Respondent Should Be Stricken

SFREI should not be permitted to be reimbursed $1.5 million for its attorneys' fees incurred while SFREI and its attorneys (1) engaged in *repeated and willful deceptions* of petitioner and the district court regarding its conduct in New York and (2) secretly tampered with TLT's critical witnesses. SFREI attempts to distort TLT's position by arguing that the mere assertion of SFREI's defense—which was found by the district court to be "entirely devoid of merit"—does not require setting aside the attorneys' fee award. Petitioner is not claiming that it is the mere assertion of

[8] Right after trial, in opposition to SFREI's motion for contractual attorneys' fees, TLT asked for discovery based on its suspicion that SFREI paid the witnesses' attorneys' fees. The district court denied TLT's request for discovery without determining whether SFREI had agreed to pay the attorneys' fees. *Terrydale Liquidating Trust* v. *Barness*, 645 F. Supp. 920, 925 (S.D.N.Y. 1986). Then, in opposition to SFREI's supplemental application for attorneys' fees, still suspecting that SFREI tampered with its witnesses, TLT again requested discovery on this issue by a formal motion. In response, the attorneys for SFREI and the witnesses, for the first time, disclosed the agreements and payments (145a-148a, 158a-159a, 160a-162a) (See Pet. 6).

the defense; it is the *repeated* filing of false affidavits, motions and briefs which misrepresented and omitted the facts establishing personal jurisdiction, *in addition* to the witness tampering, which justifies such relief. Significantly, SFREI does not refute—as it cannot—any of the *facts* establishing SFREI's repeated misrepresentations. Thus, whether these undisputed facts establish misrepresentation and deception is a question of law, which should now be reviewed by this Court.[9]

Contrary to SFREI's assertions, the court and petitioner obviously were deceived by SFREI as proven by the fact that SFREI was successful on two motions to dismiss and in opposing one motion to reargue on the ground of lack of personal jurisdiction (Pet.3). The court's prior opinion demonstrates that the deception practiced by respondent and its attorneys had effectively misled the court to an erroneous legal conclusion.[10]

In sum, there is nothing "fictitious" about the undisputed fact that SFREI and its attorneys secretly agreed to pay and paid $50,000 in attorneys' fees for TLT's critical witnesses. Nor is there anything fictitious about the undisputed facts of SFREI's misrep-

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[9] Given that the District Court ultimately found SFREI's jurisdictional defense to be "entirely devoid of merit," SFREI's note (RB 18 n.11) attempting to challenge jurisdiction is disingenuous. Similarly, a frivolous defense cannot be asserted merely "to preserve the defense for appeal." RB 18 n.11.

Further, this Petition is not rearguing the District Court's "conclusive factual determinations" because the District Court made no factual determinations regarding SFREI'S deceptive conduct. The only finding the court made was that SFREI's defense was "entirely devoid of merit."

[10] The court was specifically misled by SFREI and its attorneys' deliberate refusal to inform the court that *Skadden executed documents in New York*, on behalf of SFREI, in connection with converting Lincoln Tower Building Co.'s right of first refusal into an option. *Bolton* v. *Gramlich*, 540 F. Supp. 822, 845 n.38. (S.D.N.Y. 1982). At that time, the court granted SFREI's motion to dismiss on the basis that plaintiff's claim that "SFREI must have had some involvement in the Lincoln-Terrydale modification of the right of first refusal" was "speculation." The *fact* was that Skadden on behalf of SFREI executed documents in New York in connection with the Lincoln-Terrydale modification, which was essential for the transaction's consummation.

resentations regarding its New York contacts. The admitted facts establish an undeniable fraud warranting an order vacating the judgment and striking the award of attorneys' fees.[11]

CONCLUSION

For reasons stated herein and in the petition, the petition for a writ of certiorari should be granted.

Respectfully submitted,

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October 19, 1988

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[11] The Second Circuit's erroneous conclusion that the claims were "without any merit whatsoever" does no more than explain why petitioner seeks review by this Court. Repetition of the quote five times in respondent's brief does not aid its attempt to prejudice the petition. Similarly, every appeal and petition is motivated by a "desire to escape from the judgment" below (RB 3). Respondent gains nothing in its petty attempts to belittle the petition.

The Florida Bar

July 28, 1982

JOHN F. HARKNESS, JR
Executive Director

TALLAHASSEE, FL 32301-8226
904/222-5288

Staff Opinion TEO83026

Dear

I am responding to your request for an ethics opinion. Staff counsel are authorized by the Board of Governors of The Florida Bar to issue opinions which are advisory in nature. Should you disagree with my opinion, you may request an advisory ethics opinion from the Professional Ethics Committee by writing to the committee in care of this office. Requests for a committee opinion must be accompanied by either a brief or a memorandum with citations to authorities. Committee opinions are not usually rendered in less than four months.

In your letter of July 15th, 1982, you present the following situation. You recently represented a defendant in a personal injury matter which was settled. Soon thereafter, you were contacted by the roommate of the plaintiff (R) who voluntarily admitted to you that she had falsely answered certain questions on her deposition concerning the damages issue.

R has since obtained legal representation and is willing to testify as to the falsity of her earlier deposition and other related matters if she is given immunity from prosecution. R's attorney has indicated to you that, in his opinion, his attorneys' fees would be payable as part of his client's "expenses reasonably incurred" within DR 7-109(C).

Specifically, you request an opinion concerning the following questions:

a. Whether payment by your client of the witness's attorneys' fees in obtaining immunity is ethically permissible under DR 7-109(C), and Canon 9.

b. Whether you presently have a duty to contact the court under DR 7-102(B)(2), where you have yet to "clearly establish" by independent investigation that a fraud was perpetrated upon the court.

c. Whether you have an ethical duty to contact the State Attorney's Office in light of an admission by a witness that she committed felonious perjury.

In response to the first question, although research has revealed nothing directly on point, it appears to be permissible under the Code for your client to pay the witness's attorneys' fees related to her obtaining immunity from prosecution. DR 7-109(C) states that a lawyer may advance, guarantee, or acquiesce in the payment of: "(1) expenses reasonably incurred by a witness in attending or testifying." It is likely that R will not testify unless she is given immunity from prosecution. Therefore, the attorneys' fees associated with R's attempt to obtain immunity, a prerequisite to her testifying, are expenses "reasonably incurred" within the meaning of DR 7-109(C).

Your second question is resolved by reference to Advisory Opinion 75-19 and Proposed Advisory Opinion 82-3 (copies enclosed). Although these opinions concern an attorney's duty to reveal a fraud perpetrated by a client [DR 7-102(B)(2)] the reasoning followed by the Professional Ethics Committee is applicable to situations involving non-clients as well [DR 7-102(B)(2)].

In 82-3, the committee noted that under DR 7-102(B) the test or standard is that the information possessed must "clearly establish" fraud on the tribunal. "The committee is not a fact-finding body" the opinion stated, "nor is it able to glean from limited correspondence, and then weigh, all the substantive factors and factual considerations which would enter into the determination of whether fraud is clearly established. The responsibility for this factual determination must remain with the inquiring lawyer."

Advisory Opinion 75-19 concerned a client who had expressly confirmed to the attorney that he (the client) knew the true facts and had deliberately lied under oath. Thus, the committee concluded, the attorney possessed more than adequate information "clearly establishing" the client's fraud on the tribunal during the lawyer's representation and disclosure was required.

Under the circumstances described in your letter, it appears that you have received information "clearly establishing" that R. has perpetrated a fraud upon a tribunal and have a duty to reveal the fraud to the tribunal.

Your third inquiry relates to your duty to inform the State Attorney's Office of R's admission that she committed felonious perjury. The Code of Professional Responsibility does not mention the existence of such a duty. Should you conclude that you are obligated under DR 7-102 to inform the court that a fraud was perpetrated against it, in doing so you are meeting the disclosure requirements of the Code. Any criminal action to be pursued beyond that point is at the discretion of the court.

[Alabama]

ETHICS OPINION
RO-82-699

QUESTION:

"Pursuant to your request by telephone this date, I am requesting an opinion of the Disciplinary Commission concerning a proposed action on my part. Of course, I know this matter will be treated confidentially.

I am defending a lawsuit in Federal District Court in which my client may be liable for several million dollars. A most important part of our defense is the sexual impropriety on the part of the plaintiff toward several individuals. Because the nature of this subject, several individuals who were involved with the plaintiff now deny any such involvement.

I have talked at length with a lady who was involved with the plaintiff and in a manner most damaging to the plaintiff. This witness lives in a northern state. I have her telephone number but do not know her home address. She is planning to be married right after the first of the year but I do not know the name of her fiancee and will not, in all probability, be able to find her after the first of the year. It was by a fortuitous circumstance that I obtained her telephone number initially.

This witness expresses great hesitation about testifying to the truth concerning her relationship with the plaintiff. Because she was married when the relationship took place, because of the strain on her relationship with her present fiancee, because of the likelihood of her family finding out of her previous involvement with the plaintiff in that circumstance, because of what she claims to be mental anguish at having to so testify, and because of legitimate out-of-pocket expenses and loss of wages, her attorney has demanded a fee for her deposition testimony. I have fully disposed this to my client and the client has approved the payment of the fee. I would anticipate that the fee be paid to her attorney as an attorney fee and that he and the witness make whatever arrangement they wish to make. The probable amount of the fee will be approximately $3,000.00.

I have discussed this situation with a local Circuit Judge and he sees nothing ethically wrong with the payment and suggested that it be made to her attorney. I have also discussed this with the Chairman of the local Grievance Committee and he sees nothing ethically prohibitive in my complying with the demand of the witness' attorney.

I do want to emphasize that the witness will only be testifying to what actually happened. This is not a payment to influence her testimony or change it in any manner. Also, as I advised you by telephone, this testimony is *crucial* to my case and would go a long way toward a favorable result for my client. Also, I have tried for almost seven months to get testimony and, due to its nature, I have not been able to and will not be able to obtain it. I am caught in a very severe time bind as far as taking this deposition and I would appreciate your and the committee's response at your earliest convenience. Thank you very much for your courtesy to me

in this situation. If I can provide you with any additional information, I would be happy to do so."

ANSWER:

There would be no ethical impropriety in your permitting your client to pay the approximately $3,000.00 "attorney's fee" to the attorney of the out-of-state witness whose deposition you propose to take if you do not know and do not have any reason to believe that the "content of his(her) testimony" is contingent upon the payment of the fee and retention of the fee is in no way contingent upon the outcome of the lawsuit which you are defending, and if you obtain from the out-of-state deponent and/or her attorney an affidavit setting out her actual expenses in the nature of travel expenses, loss of wages, etc. and also setting forth the amount claimed by her attorneys as attorney's fees and the nature of the attorney's services rendered such as consultation, attending the deposition, etc.

DISCUSSION:

Ethical Consideration 7-28 provides:

"Witnesses should always testify truthfully and should be free from any financial inducements that might tempt them to do otherwise. A lawyer should not pay or agree to pay a nonexpert witness an amount in excess of reimbursement for expenses and financial loss incident to his being a witness; however, a lawyer may pay or agree to pay an expert witness a reasonable fee for his services as an expert. But in no event should a lawyer pay or agree to pay a continent fee to any witness. A lawyer should exercise reasonable diligence to see that his client and lay associate conform to these standings."

Disciplinary Rule 7-109(C) provides:

* * *

"A lawyer shall not pay, offer to pay, or aquiesce in the payment of compensation to a witness contingent upon (1) the content of his testimony or (2) the outcome of the case." (emphasis and parenthesis added)

Disciplinary Rule 7-109(C), Code of Professional Responsibility of the American Bar Association provides:

• • •

"A lawyer shall not pay, offer to pay, or aquiesce in the payment of compensation to a witness contingent upon the content of his testimony or the outcome of the case. But a lawyer may advance, guarantee, or acquiesce in the payment of:

(1) Expenses reasonably incurred by a witness in attending or testifying.

(2) Reasonable compensation to a witness for his loss of time in attending or testifying.

(3) A reasonable fee for the professional services of an expert witness."

Former Canon 39, Canons of Professional Ethics of the American Bar Association, contained no reference to payment of witness fees. In Informal Opinion 847 (1965) however, the Committee on Ethics and Professional Responsibility of the American Bar Association held that it was not unethical to pay a witness for lost wages or actual out-of-pocket expenses, so long as the line was drawn between mere reimbursement and payment for testimony itself. Current DR 7-109(C), Code of Professional Responsibility of the American Bar Association, now codifies this principle.

Although DR 7-109(C) does not spell out the permissible payments to a witness as does the corresponding DR or the Code of Professional Responsibility of the American Bar Association, in Ethics Opinion 81-549 the office of General Counsel and the Disciplinary Commission approved of those payments as detailed in DR 7-109(C), Code of Professional Responsibility of the American Bar Association.

As your request for opinion indicates the witness could be entitled to certain legitimate out-of-pocket expenses. Furthermore, a nonparty witness whose deposition has been noticed is entitled to the services of an attorney for consultation and for attendance at the taking of the deposition to protect the deponent's

rights. See Informal Opinion 828, Committee on Ethics and Professional Responsibility of the American Association.

It somewhat taxes our credulity to believe that the entire $3,000.00, or a major portion thereof, will be allocated by the witness and her attorney to attorney's fees. However, absent knowledge on your part or reasonable cause to believe that a portion of the sum will be paid to the deponent to influence the content of her testimony and since the payment is in no way contingent upon the outcome of the case you are defending, we can see no ethical impropriety in your permitting your client to pay the sum to the out-of-state attorney.

We have Shepardized Disciplinary Rule 7-109(C) and can find no opinions of courts or committees that are helpful in resolving the problem that you pose. We hasten to state that we are somewhat skeptical of the actions of the out-of-state attorney but this is a matter for investigation and action by the appropriate disciplinary committees of his state bar. In summary, based upon the limited facts which are available to you and are available to us, we conclude that we can find no provision of the Code of Professional Responsibility that would preclude the payment that you purpose.

Of course, if it comes to your knowledge that a portion of the sum paid to the out-of-state attorney will be paid to the witness in order to influence the content of her testimony you would not only be guilty of violating DR 7-109(C) but also DR 1-102(A)(2) which provides:

"A lawyer shall not:

* * *

(2) Circumvent a Disciplinary Rule through the actions of another."

There are certain inherent dangers in the course which you propose to pursue. For example, if counsel for the plaintiff in the suit that you are defending should learn of the payment of the attorney's fees to the deponent's attorney and could further establish that a portion of this sum went to the witness which was in excess of her out-of-pocket expenses, the credibility of this witness could be virtually destroyed.

As hereinabove noted in the answer, we feel that you should obtain from the witness and/or her attorney an affidavit delineating the out-of-pocket expenses incurred or to be incurred by the witness and the basis and amount of the witnesses attorney's fee.